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Annuity Ownership Considerations

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What is an annuity owner?

The owner or holder of an annuity policy

An annuity owner owns, or holds, an annuity policy.

An annuity policy is a contract between you and an insurance company (the issuer). In its simplest form, you pay the insurance company money, they invest it to earn tax-deferred returns, and then they pay the principal plus earnings back to you and/or your beneficiary. What most distinguishes an annuity from retirement plans is that income payments can be guaranteed for a lifetime and there's typically no limit to the amount that can be purchased in a given year.

Usually the purchaser of the annuity policy

The owner is usually the purchaser of the policy. However, the owner may also acquire the policy by gift, sale, exchange, or bequest.

Usually the annuitant

The annuitant provides the measuring life for determining the amount of the annuity payouts, in the event the option to annuitize is elected. The owner is usually also the annuitant.

Technical Note: *This discussion pertains to commercial annuities. It does not pertain to private annuities , which are contractual arrangements between private parties.*

What are the owner's rights?

Can name and change (i.e., designate) the beneficiary

The beneficiary receives the remaining benefits, if any, at the death of the owner. Generally, the owner has the right to name and change the designated beneficiary at any time during the accumulation period, unless the designation is irrevocable. Typically, an official form from the insurance company must be completed to make the change.

Caution: *Naming an irrevocable beneficiary may constitute a gift, subject to gift tax.*

Can select the settlement option

If annuitization is elected, the owner has the ability to select and change the settlement option .

Can select the annuitization starting date

The owner chooses the annuitization starting date. The annuitization starting date is the first day of the first period in which annuity payments are received under the contract. Thus, if annuity payments are made each December 31 and if the first annuity payment will be made on December 31 of Year 1, the annuitization starting date is January 1 of Year 1.

Can take dividends

An owner may receive dividends with respect to an annuity contract. Dividends with respect to an annuity contract entered into after August 13, 1982 are taxable as ordinary income to the extent the cash value exceeds the investment in the contract at the time of the distribution.

Can make cash withdrawals

An owner may withdraw cash from an annuity contract before the annuitization starting date. If the contract was entered into after August 13, 1982, withdrawals will be treated as coming from earnings first, and then, after earnings are exhausted, out of investment in the contract.

Caution: A 10 percent premature penalty tax may apply if withdrawals are made prior to age 59½.

Can surrender the policy

An owner may surrender the policy. In this case, the owner receives the cash value of the policy, minus any surrender charges (this is called the net surrender value). Taxes and early withdrawal penalties may also apply.

Can assign or use the policy as collateral for a loan

An owner may assign the policy or use it as collateral for a loan. This may create a taxable situation for the owner.

Can give it to someone else

- Pre-April 23, 1987 annuities--An owner may give the annuity policy to someone else. If the annuity contract was issued before April 23, 1987, the owner must report as taxable income the excess of the cash surrender value over the principal at the time of the gift in the year the donee (the recipient) surrenders the policy. Any gain earned subsequent to the date of the gift is taxed to the donee.
- Post-April 23, 1987 annuities--If an owner gives to someone else an annuity policy issued after April 23, 1987, the owner will be treated as having received a nonannuity payout distribution (NAD). The amount of the deemed distribution is the cash surrender value of the policy as of the date of the gift minus the principal. The owner must include that amount in gross income in the year in which the gift is made.

Can exchange the policy

In certain circumstances, an owner may exchange an annuity policy for another annuity policy free of income tax (this is referred to as a Section 1035 exchange).

Can sell the policy

In certain circumstances, an owner may sell the annuity policy. The income earned by the policy is taxed to the owner as ordinary income.

Who should be the owner?

A natural person

An annuity earns income over time. In the case of an annuity held by a natural person (e.g., you or me), the income is not generally subject to income tax until it is actually distributed.

Not a non-natural person

A non-natural person is an entity (e.g., a corporation or trust). Entities are not allowed the same tax-deferral advantage as individuals (this is called the "natural person" rule). There are some exceptions to this rule:

- Annuities held by a qualified retirement plan or IRA.
- Qualifying funding assets (i.e., annuities used to fund structured settlements and periodic payments for damages). Structured settlements are used by insurance companies to pay damage awards in civil law suits.
- Immediate annuities (i.e., annuities purchased with a single premium, the annuity starting date of which is no more than one year from the date of the annuity and which provide for a series of substantially equal periodic payments to be made no less frequently than annually during the annuity period).
- Annuities received by a decedent's estate by reason of the death of the decedent.
- Annuities purchased by an employer on termination of a qualified plan.
- Annuities held by certain trusts (e.g., grantor trusts) or other entities as agent for a natural person are considered held by a natural person.

Investors who plan to hold the policy for a long period

There are loads and fees charged for annuities. Investing in annuities for the short term may not make economic sense.

Younger investors

Younger investors who can afford to tie up their investments for a long period of time (preferably to age 59½) and would benefit from tax deferral and the power of compounding may benefit greatly from an annuity.

Caution: *Investors should avoid taking withdrawals from the annuity before age 59½; otherwise, a 10 percent premature penalty tax may apply.*

Persons who have already made the maximum contribution to their qualified retirement plans

Although annuities offer tax-deferral benefits, qualified retirement plans offer the same benefits plus a current tax deduction. People who have not made the maximum contribution to their qualified plans would benefit more by continuing to make contributions rather than investing in annuities.

What if the owner dies?

Before the annuitization starting date

If the owner dies before the annuitization starting date, within 60 days of the date the lump-sum death benefit is payable, the beneficiary may elect to annuitize the contract over a period no greater than his/her life expectancy, or take a lump sum distribution of the entire interest in the annuity. Otherwise, the annuity must be completely distributed within five years of the date of death.

Payments to named beneficiaries

The remaining interest (the "refund" or "death" benefit) must be paid out to the named beneficiary beginning no later than one year after the death of the owner. An exception to this rule is if the sole beneficiary is a surviving spouse. In this case, the surviving spouse may step into the decedent's shoes, become the new owner of the annuity contract, and is permitted to continue the annuity contract with no change.

On or after the annuitization starting date

If the owner dies on or after the annuitization starting date and before the entire interest in the contract has been distributed, the remaining interest in the contract must generally be distributed at least as rapidly as under the method of distribution being used as of the date of the owner's death.

Payments to beneficiaries that are classified as income in respect of a decedent (IRD)

Payments received by the beneficiaries after the owner's death may be classified as income in respect of a decedent (IRD) . Payments that exceed principal are taxable as ordinary income and are also includable in the owner's gross estate for estate tax purposes.

Is the annuity includable in the owner's estate?

Proceeds payable to the owner's estate

Proceeds payable to the owner's estate are includable in the decedent owner's gross estate for estate tax purposes.

Proceeds payable to a beneficiary

The amount received by a beneficiary is generally includable in the decedent owner's gross estate for estate tax purposes.

Tip: *Proceeds payable to a spouse qualify for the* unlimited marital deduction *. Proceeds payable to a* qualified charity *qualify for the* charitable deduction *.*

What risks does the owner assume under a variable annuity policy?

The owner of a variable annuity policy assumes the investment risk. If the funds in the account are invested poorly, the owner will receive less.

Caution: *Variable annuities are long-term investments suitable for retirement funding and are subject to market fluctuations and investment risk including the possibility of loss of principal. Variable annuities contain fees and charges including, but not limited to mortality and expense risk charges, sales and surrender (early withdrawal) charges, administrative fees, and charges for optional benefits and riders. Variable annuities are sold by prospectus. You should consider the investment objectives, risk, charges, and expenses carefully before investing. The prospectus, which contains this and other information about the variable annuity, can be obtained from the insurance company issuing the variable annuity or from your financial professional. You should read the prospectus carefully before you invest.*

To schedule an appointment with Faye Sykes, click here .

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