



## THE PROS AND CONS OF ANNUITIZING

For owners of annuities, an important question arises when they want to begin drawing income from the annuity: should they annuitize their payouts? The choice is important because often you can't change your mind once payouts begin. Here's a look at the pros and cons, and how annuity companies are beginning to offer more flexibility in their contracts regarding payouts.

Annuitizing a fixed annuity means you convert the pool of money you've accumulated in your contract into a stream of income, which typically is paid to you monthly. Let's assume you've held a deferred annuity long enough so you won't face any contract surrender issues or early withdrawal charges (before age 59 1/2). The advantages of annuitizing include:

**Not outliving your money.** One of the major attractions of annuities is the option to choose guaranteed payments for a specified period of time, including lifetime. People wanting regular income or worried about outliving their retirement funds find this feature especially attractive.

**Getting a tax advantage.** With annuitized payments from nonqualified annuities (whose premiums are not tax deductible), part of the payment is considered a return of principal for which you've already been taxed, so you pay taxes only on the earnings portion. Non-annuitized payments are considered first a return of earnings, so taxes are assessed up front on the entire payment until all earnings are withdrawn.

If you don't annuitize, you can take your money out in a single lump sum or in multiple withdrawals, or you can leave the money in the policy and let it continue to grow. The advantages of not annuitizing are:

**Flexibility.** You can withdraw money as you need it. Well-off retirees may find they don't need regular payments and can leave the accumulated funds to their heirs. With some annuities, you have the option of making systematic withdrawals if you want the benefit of a certain payment amount each month, but with the flexibility of changing that amount. On the other hand, annuitized payments typically keep you from taking out extra money in the event of an emergency, and the buying-power of fixed payments may be reduced by inflation over time.

**Benefiting heirs.** A major drawback to annuitization is that when the annuitant dies, any funds remaining in the contract usually go to the insurance company, not the heirs. Proponents of annuitization point out that this problem can be addressed in several ways. For example, you can name a joint annuitant (a spouse or child, for example). The payout will be smaller, but it will continue for the life of the remaining annuitant. You can choose a term-certain payout, such as for ten years. If you die before the term is up, payments will continue to designated beneficiaries. Another option is to use the money to buy a life insurance policy inside an irrevocable life insurance trust. When you die, the policy proceeds will pass tax free to your heirs.

However, critics of annuitization contend these strategies are needless because you can accomplish the same results by making systematic withdrawals from the policy instead of annuitizing, in which case the remaining funds go to the heirs.

Fortunately, some annuity companies are making these decisions a little easier by offering more flexible payout options. For example, a company may allow variable annuitized payouts for nonqualified annuities (qualified plans have commonly offered this feature). These payouts might be lower than nonflexible payouts initially, but might increase each month or year to keep up with inflation. Another option is to annuitize only part of the contract. Before this option became available, your only choice was to split the contract into two contracts and annuitize one of them. Still another option is to receive part of the payment as a single-life payout and some as a joint-life payout. Some companies are even allowing owners of an annuitized contract to convert payments to a lump sum or take money out in an emergency.

Obviously this wide variety of choices can make it difficult to decide which payout option is best. This is definitely an area where your Certified Financial Planner practitioner can help you sort through the options and choose the one that best meets your overall financial needs.

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