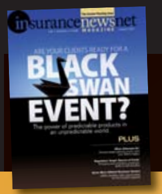

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Tax Deferral Optimization

Why Multi Year Guaranteed Annuities Make Good Tax Cents

BY JOHN RAFFERTY

The Multi Year Guaranteed Annuity (MYGA) is one of the most conservative accumulation products offered by the insurance industry. It is our industry's version of the banking industry's certificate of deposit (CD) – the rate is fixed and the risk is low. The main differences are that an MYGA is not FDIC insured as bank CDs are, and it offers tax deferral of interest earnings during the accumulation period.[1]

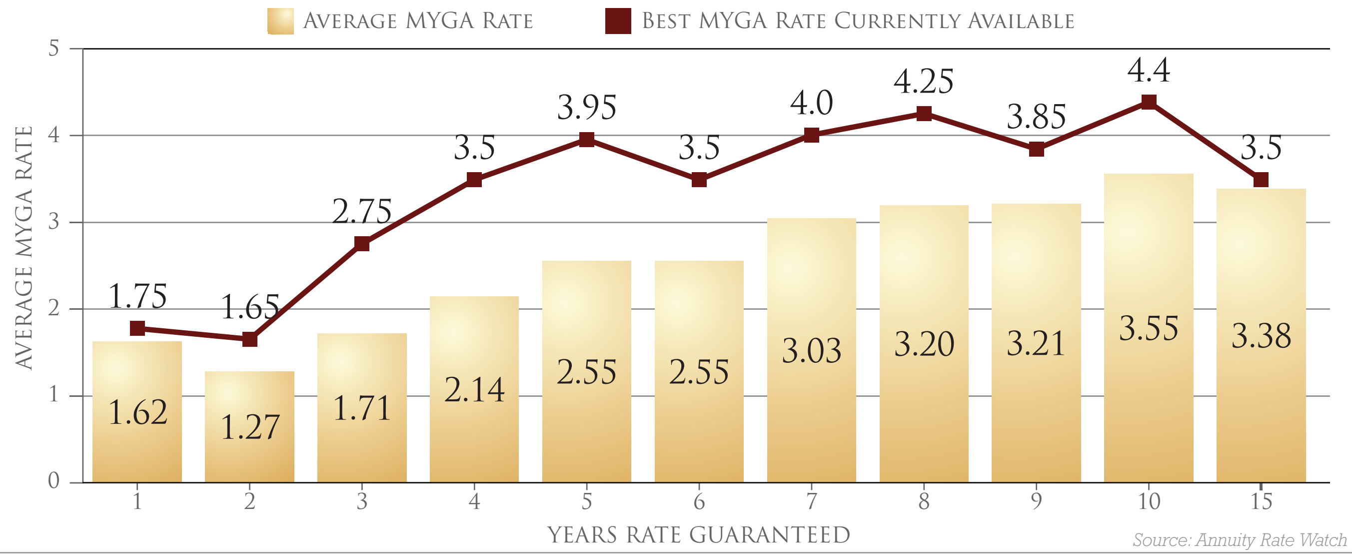
After last year's financial meltdown, a more conservative approach to financial planning, including incorporating more conservative products into clients' investment mix, has come back into vogue. So when clients are faced with the decision to put their hard-earned money into a CD or an MYGA – when current interest rates are essentially equal – what sets the MYGA apart and makes it the better option?

The Tax Bracket Impact: Working Years Versus Retirement Years

The answer lies in tax brackets, tax deferral and knowing how to optimize the impact. There are six federal income tax brackets: 10, 15, 25, 28, 33 and 35 percent. During their working years, many people are typically in a higher tax bracket than they will be during their retirement and consequently are

[1] Fixed annuities offer tax deferral of interest earnings during the accumulation period and are guaranteed by the issuing insurance company, whereas interest income from CDs is reportable and taxable as it is earned, but CDs are guaranteed by the FDIC. As with any long-term investment, annuities typically impose a schedule of preset early- withdrawal charges (though a portion of the annuity may be available penalty-free each year). CDs are generally for more short-term use and have preset early-withdrawal penalties on any amounts accessed prior to the end of the term; a CD's withdrawal penalties renew each time the CD is renewed.

Average and Best MYGA Rates by Guaranteed Period



Source: Annuity Rate Watch

paying higher taxes during that time on any investment returns.

And that tax rate can always change. A Sept. 13 article in *The Wall Street Journal* titled "Higher Taxes Are Coming. Are You Prepared?" by Laura Saunders brought that volatility to light:

"As the recession and bailout have pushed this year's federal budget deficit to an unheard-of $1.6 trillion, an unpleasant reality has dawned: Taxes are going up. The only questions are when, how much and for whom?

The answers depend on the shifting sands of wealth politics and the scope of health care revision."

For individuals with retirement on the horizon, the idea of paying more taxes now and having less money to draw on in the future can be an unsettling thought. So how do you find ways to protect clients' assets and minimize their tax burden, especially during the years when they may be susceptible to a higher tax rate?

Let's use an example to bring this concept to life. Ed and Mary Smith are a middle-class couple in their mid-50s, five years from retirement and making $80,000 per year, putting them in the 25 percent federal tax bracket.

- If the couple takes $100,000 and invests it in a five-year CD, at a current rate of 3 percent, they would earn $3,000 annually, which would be subject to annual taxes at the 25 percent bracket or $750 annually.

- If the couple takes $100,000 and invests it in a five-year MYGA, also at a rate of 3 percent, all earnings over the five-year period would be tax-deferred. Then in five years when they retire, assuming their total income in retirement is $60,000, they drop into the next tax bracket, which is 15 percent. Assuming they pull out that same $3,000 that they were being taxed on each year they owned the CD during their working life, they are paying taxes at a much lower rate – 40 percent lower, to be specific.

That drop from the 25 percent to the 15 percent marginal bracket is nominally a 10-point drop but proportionally a 40 percent reduction in tax. So what was once a tax bill of $750 drops to $450. And optimizing one's finances to take advantage of what is currently the biggest gap between adjacent federal tax brackets – 15 to 25 percent – can make good sense for many middle- and upper-middle-income earners.

Integrating MYGAs Into Your Customer's Financial Plan

With fixed MYGAs, as with any longer-term investment product, producers should first make sure that money being invested in an MYGA is money the client won't need in the short term, as there are surrender and tax penalties for early withdrawal, on top of normal income tax implications.

Producers should then look at their client list and circle any who are slated for retirement in the next five to 10 years, who are in the lower end of the 25 percent tax bracket ($68,000-$137,000 annual earnings for married couples filing jointly), and who currently have money in CDs. By illustrating the tax savings, you can demonstrate that, in many cases, the move to an MYGA can make good sense.

Your clients work hard for their money, and with planning and the right financial vehicles, they can optimize their returns, keeping more for themselves and sending less to the IRS. INN

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