The Power of Tax-Deferred Annuities

It should be of little surprise that investments allowed to grow without yearly sacrifices to federal, state, or local taxes may produce more for the individual investor. Interest, dividends, and capital growth not subject to current taxation are every investor's dream, but how can they become reality without the lower yields of tax-exempt investments?

The answer may lie in **tax-*deferred* investments** which, while *ultimately* subject to taxation, have the "breathing space" necessary to grow free of taxation for years before the funds are needed.

The investment most often thought of for tax-deferred growth is the **Individual Retirement Account (IRA),** which offers many tax advantages, but is limited in its power to offer investors an answer to their financial planning needs. Therefore, many investors have turned to **deferred annuities** as desirable vehicles for tax-deferred growth.

The Annuity Opportunity

An annuity can be purchased for a single lump sum, a periodic fixed premium, or a variable premium paid at irregular intervals. A deferred annuity accumulates deferred earnings until a future time when it is paid out.

Investors can choose between either a **fixed** or **variable annuity**. A *fixed* annuity offers investors relatively low risk to principal and a guaranteed interest rate, subject to the claims-paying ability of the issuing insurance company. Fixed annuities are not insured by the FDIC. If growth potential similar to that of **mutual funds** is desired, a *variable* annuity may offer more potential advantages. However, bear in mind that variable annuities (unlike mutual funds) involve insurance costs, such as mortality and expense fees, as a result of the **death benefit guarantee**.

Although a tax deduction cannot be taken for money put into an annuity, the funds accumulate free of taxation until they are withdrawn. All or part of an annuity balance may be withdrawn at any time, although there may be a 10% federal income tax penalty (as with **Individual Retirement Accounts (IRAs)**) on interest withdrawn before age 59½.

Annuity payments consist partly of a return of capital and partly of interest. The latter portion is taxable, the former is not. In order to determine the amount not taxable, an **exclusion ratio** must be set up, for which the advice of a tax professional should be sought.

On the Bright Side

Annuities may offer many advantages, especially for individuals who do not wish or are unable to explore more complex investment opportunities and who wish to receive income payments at regular intervals. However, investors should be aware that investment return and principal value of annuities may fluctuate due to market conditions and shares, when redeemed, may be worth more or less than their original cost.

The options for tax-deferred growth using annuities are very appealing. However, it is always wise to consult with your financial professional to determine whether a tax-deferred annuity is suited for *your* personal financial needs.

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