

Why Your CPA Prefers Index Annuities For A Portion Of Your Retirement Portfolio

Have you heard about the remarkable savings vehicle that offers the appeal of market-linked *interest credits* without the worry of market-based *losses*? Your accountant certainly has, and he or she is beginning to weigh in on their many benefits, guarantees, and tax advantages, especially when compared to mutual fund accounts held alongside of your IRAs. Consider:

1. **An FIA owner can *never* lose money due to a down market.** Most if not all Fixed Index Annuities today *guarantee* your principal, lock in interest credits from previous years, *and* provide a guaranteed minimum annual rate of return (usually 2-3%) on that total. During a year of growth, FIA owners receive a portion, typically 55-80%, of those gains, via linkage to the published returns of the various equity indices (the S&P 500, NASDAQ 100, DJIA, Russell 2000, etc.). During a subsequent *down* year, an FIA owner's principal *and accumulated gains* are "locked in" and carried forward (also known as "annual reset") to his/her next contract anniversary. If the markets should recover the following year, the FIA owner would again receive a portion of those gains *without having to climb out of the previous year's correction*. Not only do mutual funds not provide the same benefit, *an investor can lose substantial portions of both his principal and past gains during a market downturn*.
2. **Annuities grow tax-deferred, mutual funds don't.** Simply put, this means that you benefit from "triple compounding": You earn interest on *your principal*, you earn interest on *your interest*, *and* you earn interest on the money you would otherwise have paid in taxes on both. If your annuity came with a first-year premium bonus, you would have benefitted from *quadruple* compounding, having earned interest on that bonus as well. *Non-qualified equity mutual fund gains are annually reportable and taxable, thus denying an investor the benefits of such three-fold compounding*.
3. **Many Fixed Index Annuities offer premium bonuses** ranging from 2 to 11% of the original premium contributed. Some companies even continue this for any additional premium deposits made over the next 1-7 years. *Mutual funds do not offer similar bonuses*.
4. **You control your taxes, not the fund manager.** Fixed Index Annuities grow *tax-deferred* until interest is withdrawn, thus allowing their owners to control precisely when and how much money will be taxable to them, depending upon their needs and circumstances from one year to the next. Mutual fund owners are subject to the fund manager's *annual* capital gains distributions *whether or not they redeem any shares* for additional income. Many equity funds have turnover rates averaging over 80% annually, *meaning that management sells over 80% of their fund's holdings every year*, replacing them with other stocks (and sometimes even buying the same stocks back after January 1st), often in an attempt to beat their category averages. *The reportable gains that a mutual fund shareholder must pay taxes on each year is exclusively a function of how long the fund manager holds the underlying investments he or she purchases, and has almost nothing to do with how long the shareholder has owned his or her fund*.
5. **Mutual funds often make annual taxable distributions to fund owners, even when the value of their fund has gone down in value.** Non-qualified mutual funds not only require income reporting (and the resulting annual taxation) when the mutual fund is going *up* in value, but can also impose

taxes in a year when the fund has gone *down* in value. When the markets take an extended downturn after several years of sustained growth (as they did in 2000-2002), fund managers will often resort to the selling of appreciated stocks purchased several years earlier, in order to generate gains to offset those losses. This has the effect of minimizing the fund's published loss-in-value at year end, allowing the fund to claim that it was "only" down, say, 9% on the year while it's peer group was down an average of perhaps 17%. The unsuspecting shareholder of this fund receives his year-end statement, sees his account is down 9%, and assumes incorrectly that "at least" he'll owe no taxes on his "loss" come April 15th. Three weeks later, he receives a Form 1099-Div from his mutual fund company showing several thousand dollars of reportable income. The reason for this is that the longer-held stocks which the fund manager sold to reduce his fund's year-end loss were sold *at a gain* (over their original purchase price years earlier), a gain that is now reportable and taxable to the mutual fund owner *even though his statement shows his account balance is down*. Fixed Index Annuities grow tax-deferred, cannot lose value in a market downturn, and impose no annual tax reporting as the annuity is increasing in value.

6. **FIA's avoid a myriad of tax traps.** The ownership of mutual funds may require the mutual fund owner to pay estimated taxes. Tax-deferred accumulation inside a Fixed Index Annuity does not create the same tax problem. Fixed Index Annuities are easy to position so that, at the owner's death, the annuity will not be subject to either estate or income taxes. The same tax reduction techniques do not work nearly as well with mutual funds. There are numerous, often costly, tax traps associated with the timed buying and selling of mutual fund shares, traps that do not apply to Fixed Index Annuities. Additionally, mutual fund ownership can result in the loss of tax exemptions, tax deductions, and tax credits, and mutual funds (except those held in an IRA) are usually subject to state and local income taxes in those states that have such taxes. These losses do not occur with Fixed Index Annuities and, because they grow tax-deferred, FIA's are not subject to state and local income taxes during their accumulation phase. Finally, mutual fund ownership, specifically the annual distributions made by such mutual funds, can subject the fund owner to taxation under the *Alternative Minimum Tax* (AMT). The AMT *always* results in increased income taxes. Fixed Index Annuity ownership cannot trigger the AMT in the same manner as mutual funds.
7. **Mutual funds may cause income taxation of Social Security benefits.** The annually reported earnings from mutual funds can, in many cases, cause a retired couple's income to exceed the thresholds above which up to 85% of their Social Security benefits are taxed in their income bracket. The earnings within a Fixed Index Annuity are tax-deferred until taken as income, and the annuity owner (vs. the mutual fund manager) is in control of his or her reportable income, thus enabling them to reduce or even eliminate the taxation of their Social Security benefits.
8. **Mutual funds create an income tax trap for individuals purchasing funds late in the year.** Because mutual funds must distribute realized gains to fund owners each year, fund companies usually do so in November or December. An uninformed investor purchasing such a fund during the last quarter of the year may place himself at a tax disadvantage by taking on a partial tax liability for gains which took place earlier in the year which he never saw accrued to his account. Fixed Index Annuities present no such problem when late-year purchases are made.
9. **Fixed Index Annuities are almost always less expensive to own than most mutual funds.** According to *The Wall Street Journal*, mutual fund costs include "expense ratios, turnover costs, 12b-1 fees, sales charges, out-of-pocket fees, and other expenses *totaling as much as 3% per year.*" In addition, such costs have tended to go up over time. A Fixed Index Annuity's maximum costs are always fixed at purchase and are *guaranteed* not to go up.

10. **The record-keeping requirements for owning mutual funds are significantly more complex**, especially for many retirees, than the record-keeping requirements for owning Fixed Index Annuities. The keeping of excellent records (redemptions, purchases, dates, values, commissions, etc.) is often one's only defense in the event of an IRS audit. With an FIA, one's records are kept by the insurance company, copies of annual statements are mailed to the owner, and distributions (if any) are totaled and reported at year end. Many retirees enjoy such simplicity over the complexity of a prospectus.
11. **Mutual funds are commonly part of a decedent's probated estate**, which makes such funds available to any and all creditors of the estate. In addition, they are subject to the delays and expenses of probate. Fixed Index Annuities, on the other hand, are almost always non-probate property that passes outside of probate directly to one's named beneficiaries, and is therefore *not* subject to one's posthumous creditors, unwanted public disclosure, or similar delays and costs. Your heirs receive their annuity proceeds *within weeks*, not months or years after your death.
12. **Medicaid disqualification and lifetime income.** Fixed Index Annuities may provide their owners with a guaranteed stream of income for their entire lifetime, regardless of how long they live. They can often reclassify their annuities so that they may not be "countable" assets for Medicaid disqualification of nursing home costs. This is often beneficial when reorganizing one's affairs, and converting *assets* to *income* prior to a nursing home confinement. Mutual funds cannot be converted in a similar manner, and are almost always considered "countable" Medicaid assets.
13. **Nursing Home Waiver.** Most annuities will *double* an owner's penalty-free access to cash from their annuity—often waiving any remaining surrender penalties—when such individuals suffer a serious illness, need at-home care, or become confined to a nursing home. Mutual funds do not provide a similar waiver and contingent deferred sales charges may still apply to a mutual fund account whose owner needs to sell some shares to fund the costs of such a stay.
14. **Fixed Index Annuities may provide basic as well as enhanced death benefits** to the beneficiaries of the FIA owners, *and neither the owner nor the beneficiary can ever lose money due to a down market.* Mutual funds provide no such guarantees or death benefits of any kind.
15. **FIA's allow the tax-free exchange of one contract for another.** A Fixed Index Annuity owner may exchange their annuity for a completely different annuity without triggering income taxes. A mutual fund owner cannot move funds from one mutual fund company to another without selling his shares at the former (often triggering a taxable event), and repurchasing new shares at the latter, often subject to sales charges at both.
16. **Mutual funds do not provide cost-free asset rebalancing whereas Fixed Index Annuities do.** This option is usually available among the major equity indices (the S&P 500, NASDAQ, DJIA, Russell 2000, etc.), as well as a fixed interest option, at policy anniversaries. Rebalancing one's portfolio within a family of mutual funds always requires the sale and purchase of shares, often generating both taxes and new commissions.

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