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TO: OUR CLIENTS AND FRIENDS

FROM: JACKSON M. PAYNE

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RE: FINANCIAL STRATEGIES FOR YOUR LIVES AND BUSINESSES

THE APPEAL OF ANNUITIES

Wealthy investors are wising up to the unique benefits of annuities. While these insurance-sold investment products are known as tools for turning savings into lifetime income, they are increasingly capturing the attention of high-net-worth investors as a way to maximize after-tax gains, leave more to heirs, offset the impact of inflation, and stabilize portfolios during a highly volatile time.

The Types

Annuities vary in type and purpose. A plain fixed annuity is similar to a certificate of deposit, paying a set yield for a specific period. A variable annuity is much like a 401(k), with underlying mutual-fund-like investments that grow tax-deferred. A registered index-linked annuity allows participation in a stock index's return while putting a cushion under losses. And an income annuity of guaranteed lifetime payments.

Risks and Advantages

Annuities are complex and can charge high fees that erode benefits. But investors can also find inexpensive contracts with big potential advantages. Those advantages are discussed below.

More Tax Deferral

Once you have maximized contributions to an IRA and 401(k), an investment-only variable annuity (IOVA) provides an opportunity for more tax-deferred investing. Gains grow tax-deferred and are subject to income tax rates when they are taken out. Any withdrawals prior to age 59½ are subject to a 10% penalty. Investors pay annual contract fees and expenses charged by underlying investments.

Some IOVAs are cheaper than the annual 0.5% to1% charged by 401(k)s and they have no annual limits on how much is tax-deferred.

IOVAs are great for holding tax-inefficient investments. Contracts can be customized with private placement investments like hedge funds.

Minimize Taxes in Trusts

Tax rates on trust assets are notoriously burdensome: The top 37% income tax rate kicks in on income of $13,451.

By investing trust assets in low-expense passive funds within a cheap IOVA, they can grow tax-deferred—completely shielded from the trust's onerous tax system—at a low annual cost.

Stretch Inherited Assets

The Secure Act of 2019 eliminated one of wealthy families' favorite legacy planning strategy: a so-called stretch IRA. Heirs were able to let inherited IRA assets continue to compound tax-deferred for their lifetimes. Under the new law, heirs must cash assets out within 10 years, severely truncating their potential value.

But inherited nonqualified annuities can still be stretched out over heirs' lifetimes. This can be a big win for large inheritances.

More Growth

Fixed annuities are hard to beat for investors looking for safety and yield. They protect principal and can outperform other safe investments. As high-yielding principal protectors, fixed annuities can create the kind of portfolio stability traditionally provided by bonds, enabling investors to take more risk in other areas of their portfolios.

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