

Success Strategy

Annuity Maximization



WEALTH TRANSFER PLANNING THROUGH DEFERRED ANNUITIES (ANNUITY MAXIMIZATION): A “LIVE BETTER, LEAVE MORE” PLANNING APPROACH

You have worked hard to accumulate wealth and take care of your family, and like many investors, you saved for retirement with tax-favored assets such as deferred annuities. Now that you are nearing retirement, you realize that you have been more successful than you ever imagined and do not need additional retirement income. Instead, you would like to pass your annuities on to your heirs as a financial legacy. The problem is that while an annuity is an excellent vehicle for retirement planning, it is often a poor vehicle for wealth transfer. That's because at your death, the annuity will be subject to a variety of taxes. How can you best use your surplus deferred annuity to create a larger legacy for your heirs? Wealth Transfer Planning with Deferred Annuities (Annuity Maximization) may be able to help.

WHAT ANNUITY MAXIMIZATION IS

Annuity Maximization is a way to move assets from your deferred annuity and use them to fund an Irrevocable Life Insurance Trust (ILIT).¹ This ILIT can then purchase life insurance on you (and your spouse) and potentially increase the amount of money left to your heirs.

HOW IT WORKS

First, you can create an income stream from your deferred annuity either by converting it to a Single Premium Immediate Annuity (SPIA approach), or by taking withdrawals as permitted under your annuity contract (withdrawals approach). Then, you can

create an ILIT and fund it with the after-tax annuity distribution, using annual exclusion gifts to avoid gift taxes. Finally, the ILIT will purchase a life insurance policy that will pass to your heirs at death, free of estate and income taxes.

THE BENEFITS OF ANNUITY MAXIMIZATION

An Annuity Maximization approach can help:

- Reduce estate taxes
- Reduce income taxes in respect of a decedent
- Increase amount of money left for your heirs

CONSIDERATIONS

- The SPIA approach generally creates a larger income stream, and one that is guaranteed for the life of the annuitant. A larger potential income stream means a larger potential death benefit for your heirs. However, once a deferred annuity is converted to a SPIA, the principal is gone and is not available to you in case of an emergency.
- The withdrawals approach is sometimes preferred because you can retain access to the principal of the deferred annuity in case of an emergency. However, the income stream used with this approach is not guaranteed and is generally less than the SPIA, so less life insurance can be purchased. Also, the income stream is generally not guaranteed. The withdrawals approach should not be used if you are under age 59½ because you may then be subject to a 10% federal penalty tax.

CASE STUDY: SAM AND MAGGIE MALONE

Sam (67) and Maggie Malone (62) have an overall estate of \$5,000,000, and a deferred annuity of \$750,000 which is currently growing at 5% a year. As they don't need this annuity for retirement income anymore, at their joint life expectancy in year 25 it will have grown to \$2,539,766. Under current tax law, it will be subject to combined estate and income taxes of \$2,003,168, leaving only \$536,599 for the Malone's three children.

Sam and Maggie decide to take an annual withdrawal of \$42,346 from the deferred annuity, which at the Malone's 40% tax bracket produces an after-tax income stream of \$25,408 every year.² The Malones will give this money to an ILIT which will purchase a \$2,295,583 John Hancock Survivorship UL-G Policy on their lives.³ At their death, their heirs will receive this amount free of estate and income taxes, along with the after-tax remainder of the annuity principal.

As seen below, the total amount to the heirs will be \$2,462,705; nearly five times more than without planning!

EFFECTS OF REPOSITIONING USING ANNUITY MAXIMIZATION		
	RETAIN ANNUITY	ANNUITY MAXIMIZATION
ANNUITY VALUE IN YEAR 25	\$2,539,766	\$417,668
LIFE INSURANCE PROCEEDS	\$0	\$2,295,638
ESTATE AND INCOME TAXES DUE ON ANNUITY	\$2,003,168	\$250,601
NET TO HEIRS	\$536,599	\$2,462,705

The data shown is taken from an illustration. It assumes a hypothetical rate of return and is not a representation of expected future results. Unless indicated otherwise, these values are not guaranteed.

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1. Trusts should be drafted by an attorney familiar with such matters in order to take into account income and estate tax laws (including the generation-skipping tax). Failure to do so could result in adverse tax treatment of trust proceeds.
2. Assumes withdrawals net of income tax consequences and surrender charges. Withdrawals and years to pay premium are hypothetical calculations. Premium payments are always the responsibility of the policy owner, and withdrawals from the annuity may not support such premium payments.
3. Based on Male, NS Preferred age 67 and Female, NS Preferred age 62.

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