

Why Use Single-Premium Immediate Annuities?

By John Heim, Master Broker
Personalized Brokerage Services, LLC

Almost every day I hear the question, "Why use SPIAs? They have such a low rate of return!" This is a good question, and there are many answers I will offer. But first, we need to talk about what a SPIA is, exactly.

A SPIA is a single-premium immediate annuity — a contract between your client and an insurance company. By paying in a lump sum of money up front, he is guaranteed to receive a series of payments over a certain period of time. The amount of this payment is determined by the current internal interest rate at the time the contract is issued, as well as by the choice of a wide variety of payment options. Once the contract is issued, payments are fully guaranteed for the chosen period of time.

People use SPIAs for many reasons, but the biggest reason is for income. If your client has a lump sum of money and he needs income immediately, then a SPIA is a great choice. Like I mentioned earlier, a SPIA guarantees the payments for as long as the client dictates with his payout option. And, as we all know, the number one fear among seniors is that they will outlive their income. So it makes sense that most people are attracted to SPIAs for the fact that they provide an income stream that guarantees this will never happen.

Another important reason clients put money in SPIAs is for the tax-favored income. If a client uses after-tax funds (non-qualified money) to purchase a SPIA, the income payments he receives are only partially taxed. The non-taxable portion of each payment is a level percentage that represents the return of principal over the life of the contract. Depending on the client's age and the payment option he chooses, this percentage will vary. If your client is using tax-qualified funds (e.g., IRA, TSA, 401(k)) to purchase the SPIA, the payments he receives are generally fully taxable as he receives them because they represent funds that have not been previously taxed. So as you can see, non-qualified money grants your clients distinct tax advantages to go along with the income. This would also happen with qualified money, because if your client takes a lump sum of qualified funds, he will have to pay taxes on the full amount. With a SPIA he will spread out that tax hit.

Another reason to consider a SPIA is that there is no investment risk. Once a contract is issued, you can count on the payments not changing in amount or frequency; economic conditions or investment returns may change, but the payment is guaranteed to remain the same.

You can also use a SPIA to fund life insurance or long term care insurance (LTCI). By setting up a split annuity, you can use the payments from the SPIA to pay for the life insurance or LTC premium. That way, your client never has to write the check for the policy; the insurance company will send the check directly to the company.

So, why use SPIAs if they have a low rate of return? Simple. The low rate of return doesn't matter because that is not why people put their money in SPIAs. When your client puts his money in a SPIA, he will enjoy tax advantages, the financial security of a guaranteed income he cannot outlive, and in some cases, a vehicle to help pay for life insurance or LTCI.