



# Get the facts on annuities



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**It's not all that easy these days to differentiate fact from fiction. Especially when it comes to a topic as complex as retirement planning. So, we're clearing things up by uncovering the truth behind seven common misconceptions around annuities. That way, you'll have the information to decide what's right for you.**

## FICTION

Annuities are prohibitively expensive.

## FACT

While they may be considered more expensive than some investments, annuities offer a variety of valuable benefits.

First of all, what are annuities? They are long-term, tax-deferred\* vehicles designed for retirement. Variable annuities involve investment risks and may lose value. Earnings are taxable as ordinary income when distributed. Individuals may be subject to a 10% additional tax if gains are withdrawn before age 59½ unless an exception to the tax is met.

As contracts with insurance companies, annuities can provide valuable death benefits for legacy planning, as well as guaranteed† income from add-on living benefits‡ regardless of how long you live. Modern unbundled annuities can be custom built, so you pay for only features and benefits that are important to you.

## So, are the benefits worth the price?

That depends on you. Read the chart below and decide if any or all of the benefits would work for your plan.

The benefits of an annuity	
Tax deferral	✓
Lifetime guaranteed income	✓
Death benefit protection	✓
Tax-free exchanges	✓

Additionally, many annuity products are offered in advisory share class at lower costs than traditional, commission-based products. Other annuity types, such as certain registered-index linked annuities, have no embedded fee structure.

\* Tax deferral offers no additional value if an IRA or a qualified plan, such as a 401(k), is used to fund an annuity. It also may not be available if the annuity is owned by a legal entity such as a corporation or certain types of trusts.

† Guarantees are backed by the claims-paying ability of the issuing insurance company and do not apply to the principal amount or investment performance of the separate account or its underlying investments.

‡ Add-on living benefits are available for an extra charge in addition to the ongoing fees and expenses of the variable annuity and may be subject to conditions and limitations.

## FICTION

Annuities provide no additional value when held by a qualified plan or an IRA.

## FACT

Annuities with living and/or death benefits may offer significant value in qualified accounts.

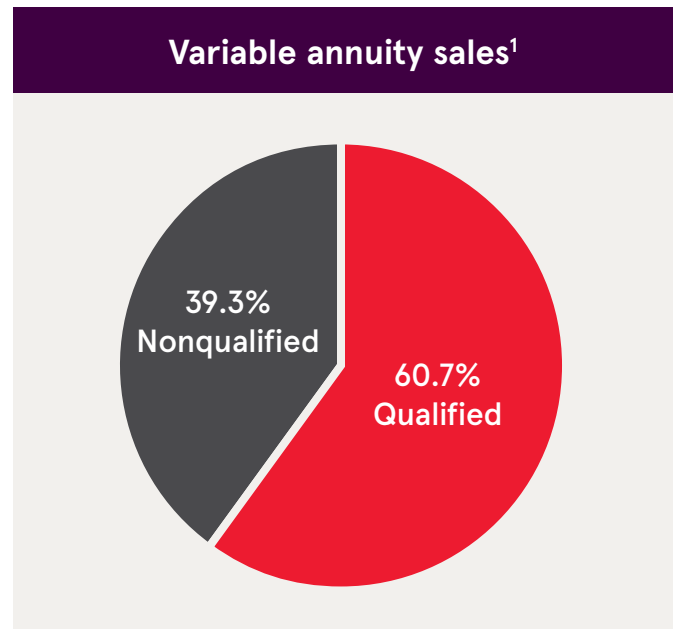
Qualified accounts, such as 401(k)s and IRAs, offer several benefits that can help the investor grow their retirement income. From a tax perspective, they not only offer the investor the ability to grow their money tax deferred, but the investor can also make pre-tax or tax-deductible contributions to qualified accounts. In addition, because these plans are qualified, they offer the potential for employer contributions—adding to the investor’s income more quickly than if they were just contributing by themselves. So, why invest qualified assets in an annuity?

Annuities are not appropriate for these types of accounts if the only benefit of the product is tax deferral; nor are they intended for short-term investors.

As we talked about earlier, there may be costs associated with annuities, but they may also offer guarantees or downside protection that an investor may not be able to access otherwise.

Annuities may offer guaranteed standard benefits as part of the contract, such as a death benefit. For investors looking for a way to provide for their heirs, an annuity death benefit may provide a legacy-planning opportunity.

Annuities may also offer living benefits for an additional cost, such as guaranteed minimum withdrawal benefits, which can provide guaranteed income for life to the investor, no matter what happens in the market.\*



<sup>1</sup> Insured Retirement Institute, "2021 Annuity Sales Report," April 7, 2022.

\* The long-term advantage of the add-on benefits will vary with the terms of the add-on benefit, the investment performance of the Variable Investment Options selected, and the length of time the annuity is owned. As a result, in some circumstances the cost of an add-on benefit may exceed the actual benefit paid.

**FICTION**

Annuities are bad investments, because gains—when withdrawn—are taxed at higher ordinary income tax rates than other investments.

**FACT**

The effective tax rates on ordinary income are seldom as high as you think.

On the surface, gains withdrawn from annuities are taxed as ordinary income with rates as high as 37% (excluding the 3.8% Affordable Care Act tax).<sup>2</sup> But that's not the whole story.

We have a progressive income tax system in the United States. In theory, that means the more income you make, the higher the tax rate you pay. However, our system actually blends all the rates as you move up the scale. For example, a married couple, filing jointly, and earning \$94,301 to \$201,050, fall into the 22% bracket but will pay between 7.79% and 13.88% on their earnings.<sup>3</sup>

The blended rate depends on their actual income within the range. At the top of the range, the rate will be close to 13.88%. That's far less than the 22% marginal rate. So with an annuity, you're really not talking about a vehicle taxed at 37% (excluding the Affordable Care Act tax).

Additionally, people are mindful of taxes, especially during their highest income earning years, but may forget about the power of tax deferral. A variety of investments are taxed on an annual basis, and those annual taxes can reduce or impede the growth and income from that asset. Since annuities grow on a tax-deferred basis, they can provide greater growth opportunities over time by not being taxed each year. Taxes will be paid on earnings when withdrawn, but those withdrawals may occur when the owner is earning less income and in a lower tax bracket.

Please note: The tax rate for long-term capital gains is 0%, 15%, or 20%, depending on income.<sup>4</sup>

Ordinary Income vs. Capital Gains at Certain Income Levels			
	Ordinary Income Rates		
Gross Income	Marginal Tax Rate	Effective Tax Rate	Capital Gains Rate
\$125,000	22%	<b>8.95%</b>	15.00%
\$195,000	22%	<b>13.63%</b>	15.00%
\$240,000	24%	15.28%	<b>15.00%</b>
\$275,000	24%	<b>16.39%</b>	18.80%
\$385,000	32%	<b>18.57%</b>	18.80%
\$425,000	32%	19.30%	<b>18.80%</b>
\$595,000	35%	<b>23.32%</b>	23.80%

Jackson calculated the information in the chart using data contained in IRS Rev. Proc. 2023-34 and IRS Topic No. 559 Net Investment Income Tax. Note: Tax rates depicted reflect the effective 2024 taxation rates for a married couple filing jointly, less the standard deduction, and do not include any additional credits or deductions. Capital gains rates reflect long-term capital gains rates, plus the Net Investment Income Tax where applicable.

<sup>2</sup> IRS Rev. Proc. 2023-34, 2023.

<sup>3</sup> Calculations performed by Jackson and assume the couple takes only the standard deduction.

<sup>4</sup> IRS, Topic 409, "Capital Gains and Losses," October 17, 2023.

## FICTION

Annuities are poor assets to pass on and/or inherit.

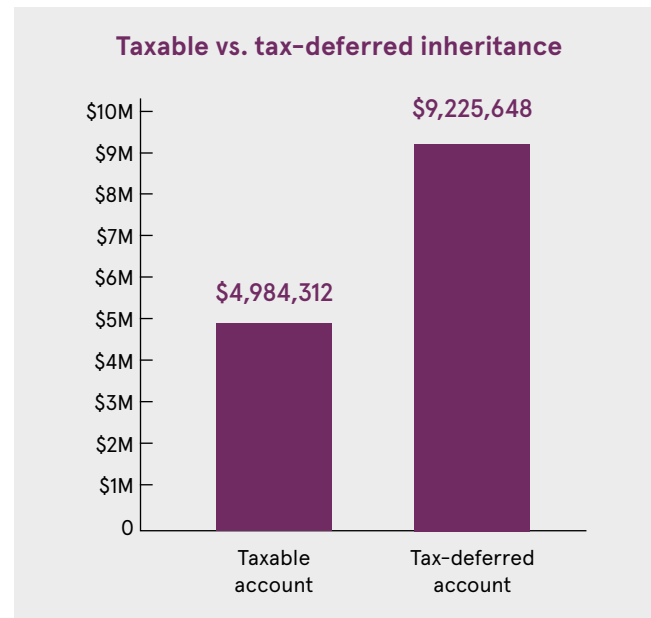
Suppose William, age 50, uses a portion of his assets to purchase a nonqualified deferred annuity for \$1 million in anticipation of his retirement beginning at the age of 65. He will need an annual income stream of \$50,000, adjusted for inflation annually (assuming 3%). He has named his daughter, Marie, as the sole beneficiary of his annuity. At retirement, assuming an 8% return, William's annuity policy has grown to a value of \$3,328,570. He takes inflation-adjusted withdrawals throughout his 20-year retirement, while remaining invested in the market. The annuity continues to grow tax deferred, while the annual distributions are taxable to William as ordinary income.

At William's death at the age of 84, his annuity contract is worth \$9,225,648 payable to Marie. If Marie takes a lump-sum distribution from the annuity, assuming an effective tax rate of 35.97%, she would net \$6,266,837 after taxes. If Marie doesn't want to take the death benefit in a lump sum or over five years, she may keep her death benefit invested and continue the tax deferral through a nonqualified stretch.\*<sup>5</sup> Marie would need to take an annual required minimum distribution (RMD) that's calculated over her life expectancy.

Although the RMDs would be taxable at ordinary income to Marie until she realizes all of the gains in the contract, the power of tax deferral has increased the total value of her inheritance. Had William chosen to use a taxable investment vehicle to meet his goals, he would have only left an inheritance of \$4,984,312 for Marie. By using a tax-deferred vehicle, such as an annuity, William leaves an additional \$4,241,336 legacy to Marie.<sup>†</sup>

## FACT

Inherited annuities may have certain tax advantages over other investments.



<sup>†</sup> This hypothetical example is for illustrative purposes only and is not representative of the past or future performance of any product. Past performance is no guarantee of future results. This example assumes an annual return of 8% and a tax rate of 20% during the accumulation and distribution phases. All calculations performed by Jackson.

An investor should consider his or her current and anticipated investment horizon and income tax bracket when making an investment decision, as the hypothetical example may not reflect these factors. The results do not reflect the impact of Required Minimum Distributions (RMD) nor are they based on a specific withdrawal percentage. Actual dividends and returns on investment may be higher or lower than the results attained in the hypothetical calculations.

\* The stretch option is only available for beneficiaries of nonqualified annuities and beneficiaries of qualified annuities who are able to stretch due to their status as eligible designated beneficiaries.

<sup>5</sup> Based on Jackson's interpretation of Internal Revenue Service, Private Letter Ruling 200151038, December 21, 2001 and HR1865, Division O, Section 1, "Setting Every Community Up for Retirement Enhancement Act of 2019," January 3, 2019.

Investors should take into consideration possible changes to tax laws, the impact of inflation, and other inherent risks when making decisions regarding distribution options.

## FICTION

A financial plan's probability of success is negatively impacted when modeling an annuity.

Today, the most commonly used financial-planning software incorporates annuities in the way they are most widely used in the marketplace—as both an investable asset and a lifetime income stream. By leveraging assets to help generate income, instead of trading assets for the sake of income, one has the potential to increase the probability of success.

Annuities can potentially grow with markets over the long term while helping to address longevity risk (outliving one's money), inflation risk (losing one's purchasing power from higher cost of goods in the future), and market risk (poor sequence of returns at retirement, or just bad luck).

Probability of success is a frequency metric that looks at how many times, in randomized market scenarios, cash flow needs would be met. Simply put,

## FACT

**Annuities could help increase a plan's probability of success.**

if the cash flow need is \$100,000 annually and the only resource is \$99,999 in pension income, every trial would fail. Why? Because this metric only offers two outcomes, either cash-flow needs would be met or not, even if the magnitude of the failure could be considered negligible. In this purely hypothetical scenario, how many people would feel their needs have not been met, that their retirement would fail? Annuities, as a part of a comprehensive financial plan, can help supplement income for essential living expenses while remaining invested in an allocation that provides opportunity for growth and keeping pace with inflation, fees, and distributions. This combination of income and asset accumulation could lead to an increase in a plan's probability of success.



## FICTION

If a trust owns an annuity, then the annuity loses its tax-deferred treatment.

## FACT

**A trust-owned annuity can retain its tax-deferred treatment if the beneficial owner is a person.**

Many people mistakenly believe that when a trust owns an annuity, the tax-deferral benefit is automatically forfeited. While the rules under Internal Revenue Code 72(u) do prohibit the tax-deferred treatment for some legal entities, that's not the whole story. In fact, trust-owned annuities may be able to retain the benefit of tax deferral. Since 1986, IRS Private Letter Rulings have been used to clarify when an annuity owned by a trust may still receive tax-deferred treatment. And those rulings generally hinge on the beneficial owner concept.

In a nutshell, if the beneficial owner of the trust is a person, then the tax-deferred treatment of the annuity has generally stood. And, it makes sense. Annuities are long-term vehicles designed for retirement, and 72(u) usually denies tax-deferred treatment for non-natural beneficial owners. However, a trust can generally retain its tax-deferred treatment if the trust's beneficial owner is a person.



Tax deferral offers no additional value if an IRA or a qualified plan, such as a 401(k), is used to fund an annuity. It also may not be available if the annuity is owned by a legal entity such as a corporation or certain types of trusts.

Jackson and its affiliates do not provide legal, tax, or estate-planning advice. For questions about a specific situation, please consult a qualified advisor.

The content on this page is our summarization of information from Internal Revenue Code Section 72(u).

The IRS issued a private letter ruling ("PLR") holding that a non-grantor trust cannot use the IRC 72(q) exceptions for (1) reaching age 59½, (2) disability, or (3) SEPP payments. The ruling recognized a non-grantor trust may use the IRC 72(q) exception for death. (See PLR 202031008).



**FICTION**

Add-on death benefits are not worth the money.

**FACT**

**Add-on death benefits provide opportunities to increase the amount you leave your beneficiaries.**

Many annuities provide a guaranteed minimum death benefit, usually the greater of contributions paid into the contract or the contract value at death. For example, if an annuity owner contributed \$200,000, never withdrew any money, and it is only worth \$150,000 at death, the beneficiary would receive the full \$200,000. The value of this benefit cannot be overstated.

Another death benefit often uniquely available to annuity owners is the step-up. This feature, usually offered at an additional cost, locks in investment gains, if any, so annuity investors can enjoy the comfort of knowing that their beneficiaries will receive a stepped-up amount. Of course, if the contract value is greater than the death benefit at the time of death, their beneficiaries will receive the contract value.

**Guaranteed minimum death benefits (hypothetical example)**

**\$200,000 beneficiary amount**



The example above is hypothetical and for illustrative purposes only. Performance indicated is not meant to illustrate or predict the past or future performance of any product. This example assumes an initial premium of \$200,000 and no withdrawals.



**To learn more about using an annuity in a financial plan, contact your financial professional or visit [Jackson.com](http://Jackson.com) today.**

**Before investing, investors should carefully consider the investment objectives, risks, charges, and expenses of the variable annuity and its underlying investment options. The current contract prospectus and underlying fund prospectuses provide this and other important information. Please contact your financial professional or the Company to obtain the prospectuses. Please read the prospectuses carefully before investing or sending money.**

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Tax deferral offers no additional value if an IRA or a qualified plan, such as a 401(k), is used to fund an annuity and may be found at a lower cost in other investment products. It also may not be available if the annuity is owned by a legal entity such as a corporation or certain types of trusts. However, under IRC Sections 72(t) for qualified plans and 72(q) for annuities, the 10% additional tax is not imposed on distributions that are part of a series of "substantially equal periodic payments." Other restrictions and limitations may apply. Jackson will not be liable for any unfavorable tax consequences resulting from use of the option selected.

Annuities are long-term, tax-deferred vehicles designed for retirement. Variable annuities involve investment risks and may lose value. Earnings are taxable as ordinary income when distributed. Individuals may be subject to a 10% additional tax for withdrawals before age 59½ unless an exception to the tax is met.

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Guarantees are backed by the claims-paying ability of the issuing insurance company and do not apply to the principal amount or investment performance of the separate account or its underlying investments.

**Firm and state variations may apply.**

