How a Non-Qualified Deferred Annuity Can Reduce Taxation of Social Security Benefits

As much as 85% of a person's Social Security benefits may be subject to federal income taxation. The exact percentage depends on how much "provisional income" the person has and how they file their tax return (see Notes).

A non-qualified (NQ) deferred annuity doesn't add to provisional income unless the owner takes a taxable distribution. As long as the gain stays within the contract, it is tax deferred and **has no impact on the tax treatment of the owner's Social Security benefits.**

Compare this to certificates of deposit (CDs)[1] and tax-free municipal bonds[2], both of which generate provisional income – which may cause more of the owner's Social Security benefits to be taxed.

If a client receiving Social Security benefits has CDs or other financial products that generate provisional income they don't need for living expenses, and they are looking to reduce taxation of their Social Security benefits, they may want to consider repositioning some of their retirement savings into a NQ deferred annuity.

The Client:

Bob and Cynthia have been married for 40 years. Bob, a construction engineer, will be retiring from his job at the end of 2012.

The Situation:

Between his pension income and Social Security benefits (both scheduled to begin in January 2013), they expect to have enough income for their retirement needs. They also have $300,000 set aside as a "nest egg", which they hope to let grow for many more years. $240,000 of this is in a bank CD that matures soon. If they renew the CD now for another 5 years, the annual rate will be about 1.67%*.

The couple were surprised to learn from their CPA that if they buy the CD, about 68% of their Social Security benefits in 2013 would be subject to federal income taxation. They expect $44,000 of adjusted gross income (AGI) – which would include about $4,000 of investment gain inside the CD – plus $24,000 of Social Security benefits. 68% of their Social Security benefits would be taxable in 2013, and at a projected 15% marginal rate would result in $2,430 of federal income taxes on those benefits.

See other side for the strategy.

This is a hypothetical example used for illustrative purposes only.
* See bankrate.com for current CD rate information.

1 Bank CD's are FDIC insured up to $250,000 per insured bank for each ownership category.
2 Income is generally free from federal taxes and state taxes for residents of the issuing state. While the interest income is tax-free, capital gains, if any, will be subject to taxes. Income for some investors may be subject to the federal Alternative Minimum Tax (AMT).

Notes:

Provisional Income = Adjusted gross income (AGI) + non-taxable interest + ½ of Social Security benefits

Threshold limits for provisional income – Based on tax filing status:

Single/Head of Household/ Qualifying Widower

- Under $25,000: Social Security benefits are not subject to taxation.
- $25,000 to $34,000: Up to 50% of benefits are subject to taxation.
- Greater than $34,000: Up to 85% of benefits are subject to taxation.

Married filing jointly:

- Under $32,000: Social Security benefits are not subject to taxation.
- $32,000 to $44,000: Up to 50% of benefits are subject to taxation.
- Greater than $44,000: Up to 85% of benefits are subject to taxation.

Source: http://www.ssa.gov

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How it Works:

Instead of renewing their CD when it matured at the end of 2012, they repositioned the money into a Genworth fixed deferred annuity with a 5-year surrender charge, and a guaranteed annual rate[3]. Although most annuities permit penalty-free withdrawals up to a certain limit each year, they chose to let the money stay tax deferred. By purchasing the SecureLiving® annuity instead of the CD, their AGI in 2013 was reduced by $4,000 to $40,000. Their Social Security benefits remained at $24,000. 53% of their Social Security benefits were taxable, and at a 15% marginal rate resulted in $1,920 of federal income taxes on those benefits. By changing from a CD to a deferred annuity, the couple was able to reduce the income taxes on their Social Security benefits in 2013 by $510. In addition, had they bought the CD, they would have incurred another $600 of federal income taxes on the investment gain within the CD for 2013. The Genworth deferred annuity provided a competitive payout, tax-deferred growth and annual tax savings of over $1,000.

Some things to keep in mind:

- Once provisional income crosses a certain income threshold, the amount of Social Security included in taxable income remains constant at 85% of benefits received, regardless of how high income goes. Higher-income clients may have to reduce income to unacceptably low levels in order to receive any tax relief.
- Growth inside a deferred annuity is income tax free until distributed. Yet, while tax-favored treatment is usually an important factor when purchasing a financial product, other factors such as risk level, expected return, fees and guarantees may be just as important to your client. Any gain distributed from a non-qualified annuity will be considered provisional income.

The Strategy:

Tax-deferred annuities (fixed or index) may produce tax-deferred income, which is not included in provisional income. Therefore, a taxpayer who converts an asset that generates provisional income (such as CDs, dividend paying stocks, municipal bonds, etc.) to a deferred annuity will reduce provisional income as long as no taxable withdrawals are taken. Reducing provisional income may reduce the amount of Social Security benefits subject to taxation.

Plan for Savings

- Help your clients reduce taxation of their Social Security benefits.
- Help them keep more of their retirement money in their pocket.

[3] SecureLiving Rate Saver Individual Single Premium Deferred Annuity Contract with Market Value Adjustment (in Illinois called Individual Modified Value Adjustment) is issued by Genworth Life and Annuity Insurance Company, Richmond, VA. Subject to policy form series ICC09GA3000, GA3000 1109 et. al.

Genworth Life Insurance Company and Genworth Life and Annuity Insurance Company are licensed in all states except New York. Only Genworth Life Insurance Company of New York is admitted and conducts business in New York.

All guarantees are based on the claims-paying ability of Genworth Life & Annuity.

Withdrawals may be taxable and a 10% federal penalty may apply to withdrawals taken before age 59½.

This is a brief product description. Consult the annuity contract for a detailed description of benefits, limitations and restrictions.

The discussion of tax treatments in this material is Genworth's interpretation of current tax law and is not intended as tax advice. Your clients should consult the contract and a tax professional.

Insurance and annuity products:	
Are not deposits.	May decrease in value.
Are not guaranteed by a bank or its affiliates.	
Are not insured by the FDIC or any other federal government agency.	

Fixed Annuities available from the following Genworth companies:
Genworth Life and Annuity Insurance Company, Richmond, VA
Genworth Life Insurance Company, Richmond, VA
Genworth Life Insurance Company of New York, 666 Third Avenue, 9th Floor, New York, NY