With Specialized Annuities, SQUEEZE Social Security for All It's Worth!

By Curtis Cloke

All clients love receiving Social Security, but most don't realize that they could be squeezing more out of their payouts. With the power of annuities, we can show them how.

Through Social Security, the government provides a means to help seniors and retirees maintain their quality of life in their later years; yet, they don't offer a plan to go with it. Facing a complex and confusing tax system, plus three main types of assets to manage (non-qualified money, qualified pre-tax money, and qualified after-tax money), most

clients have no idea that there is even the potential to boost the amount of their Social Security payouts. As advisors, it's our job to help them sift through the clutter and show them how to get it done.

In order to fully optimize Social Security, you need a two-pronged strategy of delaying Social Security in exchange for higher payouts and then minimizing taxes when the payouts start. Annuities, such as the SPIA (Single Premium Immediate Annuity) or DIA (Delayed Income Annuity), which are both term and able to help with both of these objectives of higher payouts and minimized taxes by providing: (1) a bridge to cover expenses while Social Security payments are delayed, and (2) the tax exclusion ratio, which I refer to as FIBO® (First In/Blend Out).

Finding the Bridge that's not too Far

Advisors need to show their clients the power of delayed gratification. Explain to them that yes, Social Security is great. But do they know what's even better? More Social Security! At age 62, they could be receiving the maximum monthly benefit of $1,855. But if they delay payments to age 70, their benefit amount increases to $3,266 per month for the rest of their life (based on 2012 tables at SSA.gov).

However, our clients need to cover their expenses during the 8 years from age 62 to 70. Where are they going to get their income if it's not from Social Security? One strategy is to move some of their non-qualified money into a term-certain annuity. Beyond the high guaranteed payout rate that these products offer, there are numerous tax advantages that these annuities provide.

Consider this: If the client decided to invest in stocks, bonds, or mutual funds, they would be taxed as LIFO (Last In/First Out). Everything that they gain from these investments would be subject to tax. However, income annuities are blessed with a tax exclusion ratio. Typically, only 5-25% of the payouts would be subject to tax, while 75-95% is considered a return on principal. We call this FIBO® because the income is blended out as a combination of principal and income.

For example, for purposes of comparing taxation, let's say that a client had invested in a stock mutual fund that returns on average $25,000 annually. That total amount is going to be subject to tax. At 15%, the tax would be $3,750. However, if the money is invested in a SPIA or DIA that returns $25,000, it's possible that only $5,000 would be subject to tax, assuming an 80% exclusion ratio. The same 15% tax would be reduced from $3,750 down to $750—a savings of $3,000! This strategy creates additional cash flow, and helps bridge the gap while delaying Social Security.

Watch as Taxes Magically Disappear

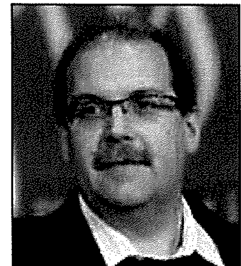
By shifting non-qualified money into the annuity, clients may also be able to move into a lower tax-bracket, since the exclusion ratio shelters a high percentage of income from tax. As seen in the previous example, only $5,000 would be counted as income, instead of $25,000, which could earn your clients additional tax savings by lowering their tax bracket. This "bracket bump" could then help clients begin to convert some of their pre-tax qualified money (traditional IRAs and 401ks) into after-tax qualified accounts, Roth IRAs.

In the later years, having more money allocated in a Roth IRA pays because it can reduce the amount of Social Security that is subject to income tax. Roth withdrawals, like return of principal from annuities, don't count toward the "combined income" formula used to calculate the amount of Social Security that is subject to tax. For instance, take a married couple who was able to shift enough money from a traditional IRA to a Roth IRA, and from non-qualified assets to annuities. They could lower their taxable income from $55,000 to below $44,000, dropping the taxable portion of their Social Security from 85% to 50%.

Why Snoopy Would Love Annuities

Snoopy summed up the U.S. sentiment best when he composed a letter saying, "Dear IRS, I am writing you to cancel my subscription. Please remove my name from your mailing list." Snoopy may have been an optimist in thinking that he could completely escape taxes, but perhaps he was on to something!

With income annuities, your clients can significantly reduce both their taxes on their investment with tax exclusion ratio and the taxable portion of their Social Security, while potentially benefiting from a decreased income bracket bump. All of this creates more savings, cash flow, and happier clients who love doing business with you. ■



Curtis Cloke, CLTC, LUTCF, award-winning financial professional, speaker, and author, is an early pioneer and advocate for deferred income annuities (DIA). His contribution toward the discovery, development, and delivery of the power of the DIA has been widely acknowledged and embraced as part of the retirement income puzzle by the financial industry. Curtis is the founder and developer of the Thrive Income Distribution System launched in 2009, which helps advisors and clients create more income by utilizing less of the client's portfolio. To learn more, visit www.thriveincome.com or www.curtiscloke.com.

"FIBO – First In/Blend Out" is a registered trademark by Curtis Cloke.

Source: NAFA Annuity Outlook