Why Partial Transfers of NQ Annuities Can Make Sense

By Danny Fisher

MOST INSURANCE COMPANIES follow the law and treat partial transfers between annuities as a tax-free exchange.

But because some companies disregard the law and still treat partial transfers as a taxable event, it's wise to confirm how the surrendering company will treat the transfer, as taxable or tax-free, before paperwork is submitted.

The question has to be asked, "Why would anyone want to make a partial tax-free transfer to another annuity?". Here are some reasons:

❶ ***Policy features.*** The ability to add money to a flex-pay annuity is a key policy feature to consider. For example, some clients own flex-pay annuities where they can add as little as $100 as often as they wish and the money is 100% liquid because the surrender penalties have expired forever. They are guaranteed to earn a minimum rate of 3.5%. The smart clients recognize this as a great contract and they don't want to give it up. However, some have large amounts of money in the contract. They often transfer a majority of those funds to another annuity to earn a higher rate but leave a small amount in the flex-pay annuity in order to "keep it open." That leads to the second reason.

❷ ***Higher rates.*** If a client has $102,000 in an annuity, he/she may transfer $100,000 to another company to earn a higher rate on the bulk of the funds. The client leaves the remaining $2,000 in the flex-pay annuity, where he/she can add smaller amounts in the future.

The rationale here is that, although the new annuity at Company B may be paying a higher rate for the next five years, the minimum guaranteed rate may be a lowly 2%. By keeping the annuity "open" at Company A, the client may transfer the money back to the "open" contract from Company B at the end of the five-year period. I hasten to add, some companies allow partial transfers into an existing annuity and some don't.

PARTIAL ANNUITY TRANSFERS

Why People Do Them

- ✔ Policy Features
- ✔ Higher Rates
- ✔ Maximize Safety
- ✔ Ladder Rates
- ✔ Liquidity

Source: Danny Fisher, Fisher Annuity Index, Dallas

❸ ***Maximize safety.*** Another reason may be the client does not want to have too much money in any company. Some people are super safety conscious. They simply won't have more than $100,000 in any one bank or savings and loan. They want their money protected under the law in the event the financial institution fails.

This extends to annuities. Clients have called me and said, "I've been asleep at the wheel and wasn't paying attention. I have $160,000 in an annuity at Company A. I want to transfer half of it to Company B. How do I do it?" I tell them, "My office will complete all the forms you need and send them to you. All you'll have to do is sign the forms and mail back to me. We'll handle it from there."

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❹ ***Ladder rates.*** Some people have read an article about the wisdom of "laddering" rates. So they call and say, "I want to move a third of my money to a three-year annuity at Company B, a third to a five-year annuity at Company C, and leave a third at Company A. When rates go up, I'll move what's left at Company A." My response is, "That sounds like a wise move to me. I'll send you the forms!"

❺ ***Liquidity.*** Yes, some people want to transfer a portion of an existing contract to another annuity to earn a higher rate, but they also want to maintain some liquidity just in case they need it. And "therein lies the rub!"

The Internal Revenue Service and some insurance companies are fearful that policy owners will abuse the partial tax-free transfer rules. As an example, if an annuity has a value of $100,000 with a cost basis of $60,000 and a policy owner decides he or she wants to withdraw $20,000 out of the contract, the $20,000 will be fully taxable. The fear is that a policy owner may transfer 80% to another company, leaving $20,000 in the original contract with a remaining cost basis of $12,000. If the policy owner then surrenders the original contract for $20,000, he/she would only owe tax on the $8,000 gain.

The fear is based on the assumption that clients think that far ahead.

I've been selling annuities for over 30 years and my experience is that most clients don't sit around trying to figure out all the tax angles.

In all these years, I may have had five people under the age of 60 who surrender an annuity. And they were in such dire need of the money, taxes was the last thing on their mind.

Clients age 70 and up often surrender annuities to meet their cash needs. The first question they ask is, "Which of my annuities is paying the lowest rate?" Again, tax evasion is simply not an issue.

Just because one in 10,000 people may abuse the system, it should not lessen the use of partial tax-free transfers. A partial tax-free transfer is a valuable planning tool used to take advantage of certain key policy features, increase interest rates, maximize safety of funds, and maintain adequate liquidity.

Any insurance company that doesn't allow partial tax-free transfers is robbing their clients of those tools. NU

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