SUPPLEMENTAL RETIREMENT INCOME

Strategic Planning Tools

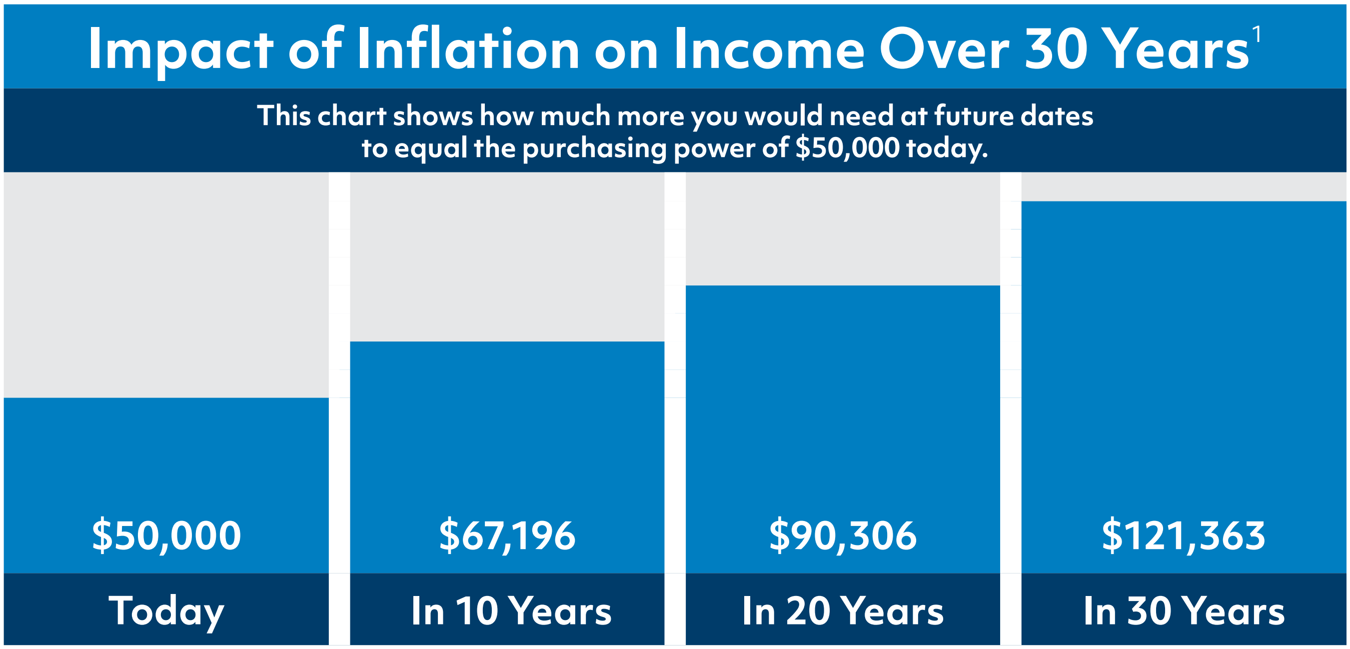
Supplemental Retirement Planning

When it comes to planning for retirement, many wonder if they have accumulated enough assets to live the life they desire during retirement.

Every retirement situation is unique; however, two factors that influence how much you will need to set aside for retirement include inflation and health care costs.

The Role of Inflation

Iinflation has a dramatic impact on the amount of retirement assets you will need. Consider the impact just modest inflation can have on $50,000.



Wild Card: The Cost of Health Care

Even the experts can't agree on how much retirees will have to pay in out-of-pocket health care expenses during retirement. Major health care expenses include:

- Premiums for Medicare Part B (physician and outpatient hospital services) and Part D (prescription drug-related expenses).
- Co-payments, coinsurance, and deductibles.
- Excluded benefits such as dental care, eyeglasses, and hearing aids.

Health care is one of the largest expenses incurred during the retirement years. Health care costs continue to rise and are projected to rise a minimum of 6% per year over the next decade. A healthy couple that retires at age 65 is estimated to spend over $250,000 in Medicare premiums alone.

In addition, Medicare premiums, which did not increase for many years, have increased for high earners in recent years. Couples whose Modified Adjusted Gross Income exceeds $170,000 will now face significantly higher Medicare B and D premiums. If retirees' income bracket exceeds $170,000, surcharges could raise their Medicare B and D premiums.

The Cost of Delayed Savings

If you did not begin saving early in your career, you will need to save much more to make up for the deficit. In fact, postponing your savings by only two years could cost you $6,845! If you start saving today, and save $2,400 annually, you could have $29,435 in savings after 10 years. In order to get the same savings balance after ten years with a two year delay, you would need to save $261 per month instead of $200 per month.

	Start Now	Start in Two Years
Starting Amount	$0.00	$0.00
Savings Plan	$200 per month for 10 Years	$0.00 Per Month for Two Years $200 Per Month for Eight Years
Rate of Return	4.00%	4.00%
Ending Balances	**$29,435**	**$22,590**

Savings Balances by Year

Start saving $200 monthly ($2,400 annually) now

Year	Additions	Interest (4%)	Balance
0	$0.00	$0.00	$0.00
1	$2,400.00	$51.68	$2,451.68
2	$2,400.00	$149.75	$5,001.43
3	$2,400.00	$251.75	$7,653.18
4	$2,400.00	$357.82	$10,411.00
5	$2,400.00	$468.16	$13,279.16
6	$2,400.00	$582.86	$16,262.02
7	$2,400.00	$702.17	$19,364.19
8	$2,400.00	$826.25	$22,590.44
9	$2,400.00	$955.30	$25,945.74
10	$2,400.00	$1,089.51	$29,435.25

Postpone saving two years then start saving $200 monthly ($2,400 annually)

Year	Additions	Interest (4%)	Balance
0	$0.00	$0.00	$0.00
1	$0.00	$0.00	$0.00
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Cost of waiting: $6,845[2]

Qualified Plan Limits

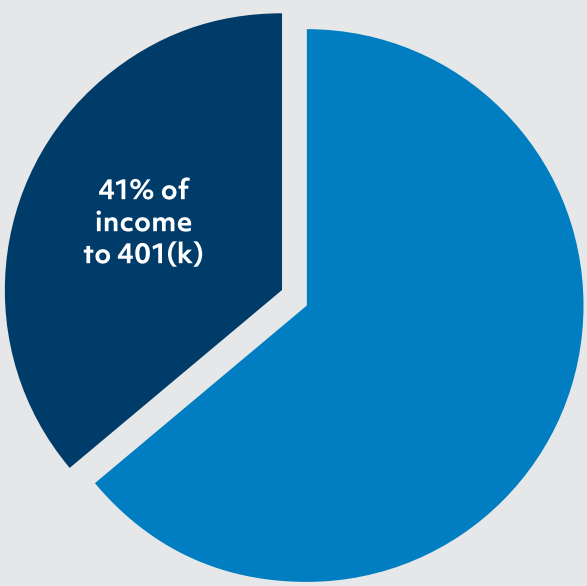
Contribution limits coupled with anti-discrimination rules place limits on how much high-income individuals can contribute to qualified retirement plans. Qualified plan contribution and benefit limits typically adjust annually and have catch-up provisions for individuals age 50 and over.

In 2022, the maximum annual contribution limit to a 401(k) for individuals under age of 50 is $20,500. This means that no matter an individual's income, the maximum contribution to their 401(k) in 2022 is $20,500.

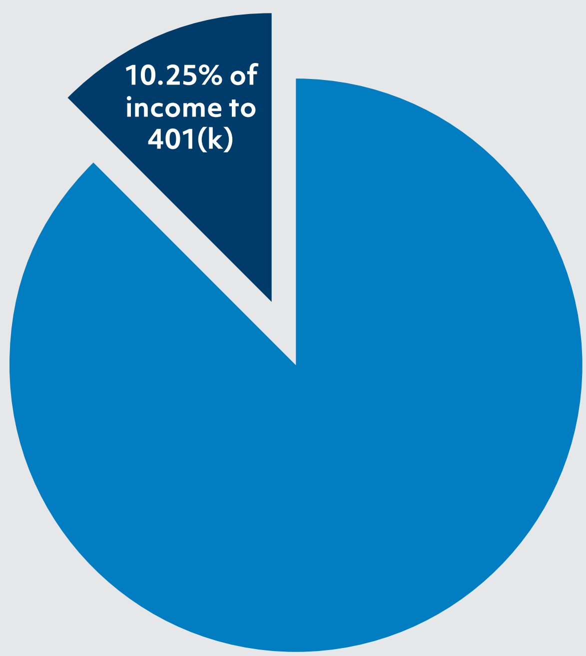
Example

In 2022, two individuals contribute the maximum $20,500 allowed to their 401(k)s.

Annual Income: $50,000



Annual Income: $200,000



For the individual with an annual income of $50,000, this may be enough to fund their retirement. The individual with an annual income of $200,000 is not able to contribute the same percentage as an individual earning substantially less. Therefore, the higher earning individual may need to look into additional retirement planning tools and strategies.

Immediate Annuities

An immediate annuity is a contract that pays a regular income to you in return for a premium payment. The income may be for a specified period of time and is normally payable for life. You choose the payout option and income payment start date/frequency. With a lifetime income option, you are guaranteed to receive income for life!

Each annuity payment includes two elements:
Tax Free Return of Premium + Earnings Taxed as Ordinary Income

An immediate annuity locks in the amount of the payment so you know exactly how much will be paid each month.

Compare this to a certificate of deposit (CD). With a certificate of deposit, the full amount of the interest received is taxed as ordinary income. Future payments will vary depending on the renewal interest rate available when the CD matures.

Deferred Annuities

Like an immediate annuity, a deferred annuity can pay a regular income. A deferred annuity may be funded with a single premium or with multiple premium payments over many years. The obvious advantage of a deferred annuity is two-fold:

- The ability of a deferred annuity to accumulate earnings over a substantial period of time.
- Growth in the value of a deferred annuity occurs without current taxation.

Tax-deferred growth significantly enhances the opportunity for a deferred annuity to accumulate substantial value and to provide excellent, stable income during your retirement years.

Like an immediate annuity, part of each annuity payment is a tax-free return of premium. The balance of each payment is taxed as ordinary income to the payee.

Annuity Advantages

- Earnings are tax-deferred as long as they remain in the annuity.
- If you die owning an annuity, the accumulated value will pass directly to your named beneficiary and avoid probate.
- You do not have to meet income tests or other criteria to purchase an annuity.
- Not subject to annual contribution limits, unlike IRAs or other qualified plans.
- You are not required to start taking distributions from an annuity at age 72 (the required minimum distribution age for IRAs and employer-sponsored plans).

Annuity Disadvantages

- Ordinary income tax may be assessed on any withdrawals.
- Income withdrawals taken prior to age 59½ may result in a 10% penalty tax by the IRS.
- Annuity contracts usually have a surrender period that will impose penalties if the money is removed prior to the end of the surrender period.

Life Insurance

Permanent Cash Value Life Insurance

With just one premium payment, the death benefit of the policy will be immediately paid to the named beneficiary income tax-free and without probate. Upon the insured's death, the tax-free death benefit can be used to realize any unfinished retirement savings goals.

Like annuities, cash value life insurance grows without current taxation. Unlike annuities the cash value can be withdrawn on a tax-free basis when properly structured. In addition, life insurance withdrawals can be made prior to age 59½ without penalty and life insurance is not subject to required minimum distributions at age 72.

Insurance Advantages

- The opportunity to save for retirement and enjoy tax-deferred growth.
- Income opportunities are available through partial withdrawals. Partial withdrawals are generally not taxed until the cash value withdrawn exceeds the total amount of premiums paid. Withdrawals reduce the death benefit and the cash available to pay for the costs of insurance.
- Generally, loans are not taxable.[3]
- Life insurance distributions can be made prior to 59½. Death benefits can be adjusted. Ownership can be transferred which can meet a variety of business and estate planning needs.
- Life insurance is not subject to required minimum distributions at age 72.

Insurance Disadvantages

- Loans can have an adverse effect on the policy cash value and death benefit if interest and loan values are allowed to accumulate.
- Premiums must be paid annually to keep the policy in effect.
- Some insurance requires a medical exam.
- Your premiums usually cannot be lowered.

Supplemental Retirement Planning Ideas

Many people put off saving because they're paying off a mortgage, educating children, or enjoying the perks of life while children are growing up. For people who have started saving late or are looking for additional ways to save, annuities and life insurance are excellent tools for enhancing capital formation and accumulating additional funds for retirement. Annuities and life insurance can offer important tax-advantaged growth and favorable tax treatment when funds are distributed.

Survivor Supplemental Retirement Income

For married workers participating in defined benefit qualified plans, current law requires that plans provide an annuity that is at least 50% of the worker's benefit to a surviving spouse. This reduces the highest payout option – the life only option – by 25% or more. To elect the life only option, your spouse must waive the right to the legally required survivor annuity benefit in writing.

Example

A $2,000 a month life only pension benefit to a retiree would be reduced to a maximum of $1,500 under the law. In other words, the worker benefit would be reduced by $500 per month for life to provide the legally required income to a surviving spouse.

How Survivor Supplemental Retirement Income Works

- Purchase a whole life insurance policy on your life. (May be subject to medical underwriting.)
- Name your spouse as the beneficiary.
- The life insurance policy creates a source of funds that will pay your spouse a lifetime supplemental income if you die first.
- Policy proceeds can be withdrawn and paid to your surviving spouse, or a settlement option can be elected that will provide a lifetime income.

Disadvantages of Survivor Supplemental Retirement Income

- Policy premiums must be paid to keep insurance in force.
- Survivor benefit may not be sufficient to pay the income you anticipate.
- If you take too much from the policy during your lifetime, the policy may not have enough left to continue the policy until death.
- Spouse may lose his or her medical benefits upon death of the plan participant.

Strategic Retirement Planning Tools

The Irrevocable Life Insurance Trust

When planning for retirement, people think about family needs and estate liquidity issues. The Irrevocable Life Insurance Trust (ILIT) is specially designed to own life insurance. This strategy assures that death proceeds do not become a part of the insured's estate for estate tax purposes.

An ILIT can be used to provide income to surviving family members while protecting trust property from the individual creditors. The trustee of the ILIT pays premiums on life insurance owned by the trust. The source of funds to pay premiums usually comes from gifts made to the trust by the trust grantor. These gifts can be structured to qualify for the annual gift tax exclusion by giving trust beneficiaries special withdrawal powers – called Crummey powers.

An irrevocable life insurance trust is a versatile planning tool that can create funds that meet beneficiary needs and provide estate liquidity, with the added advantage of keeping life insurance proceeds out of an owner's estate.

Annuity Wealth Transfer

Couples may find that a deferred annuity purchased many years ago has grown substantially but will not be needed for income during their retirement years. They may then plan for the annuity to be used for their children.

Couples who own a deferred annuity and have worked diligently over the years to achieve a comfortable life style may be dismayed when they find out how substantial the tax burden is when an estate is large enough to be subject to the federal estate tax. Although a deferred annuity would continue to grow during the couple's lifetime, there's a possibility that the annuity will be subject to estate tax at a hefty 40% rate, depending upon how much the unified credit is at the time of death. Currently, with the unified credit, an individual can pass $12,060,000 free of federal estate tax. However, beginning in 2026, that amount is reduced to $5,000,000 (indexed for inflation). In addition, federal and state income tax would also be due at a potential rate of 40% or more.

Using the Annuity Wealth Transfer Concept, estate owners can avoid substantial taxes by converting a deferred annuity to a single premium immediate annuity (SPIA).

How Annuity Wealth Transfer Works

- After paying taxes due on the single premium immediate annuity payments, the annuitant uses the balance of the payments to fund the purchase of a life insurance policy.
- The life policy is owned by an irrevocable life insurance trust (ILIT), in which payments are made to the trust and insurance proceeds are not subject to estate tax.
- Since life insurance proceeds are income-tax free, the irrevocable life insurance trust beneficiaries (the children) avoid federal and state income tax on payments from the trust.

Split Annuity Concept

A split annuity strategy involves the purchase of a single premium immediate annuity (SPIA) and a single premium deferred annuity (SPDA). This is an effective strategy when you need current income but want to take advantage of the tax-deferred growth available with deferred annuities.

Example

Assume a retiree has $300,000 in CDs and is not receiving sufficient income to meet retirement needs. The retiree purchases a SPIA for $100,000 that will pay increased monthly income for 10 years. The remaining $200,000 is used to purchase a single premium deferred annuity that is projected to grow to a value of $300,000 in 10 years.

The objective is to have the SPIA pay current income for a term of years that will allow the SPDA to grow in value over a period of time until it reaches the value of the original sum. In this way, the retiree enjoys increased income and realizes the total return of original principal.

1) Assumes 3% inflation rate. 2) Information and interactive calculators are made available as self-help tools for independent use and are not intended to provide investment advice. American National does not guarantee their applicability or accuracy in regards to your individual circumstances. All examples are hypothetical and are for illustrative purposes only. Seek personalized advice from qualified professionals regarding all personal finance issues. 3) Loans are subject to interest charges and they reduce the death benefit paid to beneficiaries.

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