Annuities vs. 401(k)s and IRAs

Feature	Annuities (Nonqualified)	401(k)s and Traditional IRAs	Roth IRAs
Tax-deferred earnings	✓	✓	✓
Tax-deductible or pretax contributions		✓	
Unlimited contributions	✓		
*Guaranteed minimum death benefit	✓		
RMDs		✓	
*Tax on withdrawals	✓	✓	
*Guaranteed lifetime income	✓		
*Fees and charges	✓	✓	✓

***Guarantees are subject to the claims-paying ability and financial strength of the issuer. The earnings portion of annuity withdrawals is subject to income tax at ordinary income tax rates. Pretax or tax-deductible contributions and pretax earnings are subject to income tax at ordinary tax rates when withdrawn. Annuities, particularly variable annuities, may impose higher fees, charges, and expenses than the other plans.**

Preview

So how do annuities stack up against 401(k)s, IRAs, and Roth IRAs?

First, annuities are a financial product sold by or through an insurance company. On the other hand, IRAs and Roth IRAs are personal savings plans, while 401(k)s are savings plans for employees offered by their employers. IRAs, Roth IRAs, and 401(k)s can be funded with a number of different investments, including stocks, bonds, mutual funds, and annuities. But you can also own an annuity separate and apart from your IRA, Roth IRA, or 401(k).

In any case, annuities, IRAs, Roth IRAs, and 401(k)s share some common features and some different characteristics as well.

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The earnings within each of these vehicles grows tax-deferred meaning you don't have to pay income taxes on the growth within these plans until they're withdrawn.

Unless an annuity is held within a 401(k) or IRA, annuity premium payments are made with after-tax dollars, similar to a Roth IRA.

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Only 401(k)s and IRAs offer tax-deductible or pretax contributions.

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There's no limit on the amount you can contribute to annuities, while the other plans have specific limits on how much you can contribute to each.

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Annuities often provide a guaranteed minimum death benefit to your heirs, which none of the other plans provide, unless they're funded by annuities or, in the case of 401(k)s, life insurance.

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You generally are obligated to take required minimum distributions from your 401(k)s and IRAs after you reach age 70½, but there's no such requirement for annuities and Roth IRAs.

As long as you satisfy specific requirements, withdrawals from Roth IRAs are not subject to income tax.

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However, all distributions of pretax contributions and earnings from 401(k)s and IRAs are taxed as ordinary income. Only the earnings portion of annuity distributions is subject to income tax.

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Here's what may be one of the most important distinctions between annuities and other retirement plans: an annuity can be annuitized, or converted into a stream of payments you, or you and your spouse, can't outlive. While it's entirely possible that the funds you accumulate in an IRA or 401(k) could last for your entire life, there's generally no guarantee--it's possible you could outlive your funds.

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Each of these plans has some fees and charges that can differ based on the investment vehicle selected. Annuities, particularly variable annuities, may impose higher expenses than 401(k)s, IRAs, and Roth IRAs.

There are different types of annuities, which we'll discuss briefly, but there are some basic characteristics common to most types of annuities.

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Parties to an Annuity

The **owner**:

- Purchases the annuity
- May make withdrawals
- Receives annuitization payments if elected

The **issuer**:

- Issues the annuity
- Accepts the premiums
- Promises* to pay the annuity benefits

*Guarantees are subject to the claims-paying ability of the annuity issuer.

The **annuitant**:

- Provides the measuring life for determining annuity payouts
- Typically, the annuitant is also the owner

The **beneficiary**:

- Is named by the owner
- Receives the remaining benefits, if any, at the owner's death

Preview

There are generally four parties to any annuity contract. The **owner** usually purchases the annuity, pays the premiums, and names the beneficiary (if any) in the event of death. The owner can make withdrawals from the annuity or surrender it, and is generally the party who receives the payments if the annuity is annuitized.

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The **issuer** of the annuity contract is generally an insurance company. The issuer accepts the premium payments, invests them in accordance with the annuity contract, and promises to pay whatever benefits the annuity contract stipulates.

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The **annuitant** provides the "measuring life" used to determine the amount of the payments if they're made for life, called annuitization. Typically, the annuitant is also the owner of the annuity.

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The **beneficiary**, named by the owner of the annuity, receives the proceeds of the annuity if the owner dies before annuitization, or receives the remaining benefits (if any, depending on the annuitization option chosen) at the time of the owner's death.

There are some other common features of annuities.

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Putting Money in an Annuity

The accumulation phase is the time period when you're making the premium payments. You can make:

- One lu
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  payme

Preview

There are two distinct phases to any annuity contract. The phase where you put money in is called the accumulation phase. The phase where you take money out is called the distribution phase. In the accumulation phase, you can choose to pay premiums in one of two ways:

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You can pay in one lump sum.

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Or, you can make a series of premium payments over time. These payments can be of equal amounts contributed at equal intervals (for example, $500 a month), or you can make payments of variable amounts at irregular intervals, depending on the terms of the contract.

You can put money in an annuity and let it earn interest, or you can begin to receive payments almost immediately.

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Immediate vs. Deferred Annuities

Immediate annuities

- Typically purchased with a single lump-sum premium
- Payouts begin within one year of purchase

Deferred annuities

- Typically purchased with periodic payments
- Payout begins at some future date, allowing time for tax-deferred growth

Preview

Annuities are classified as either immediate or deferred annuities. These terms simply refer to when the distribution phase of the annuity begins.

Immediate annuities convert a lump sum of cash into an income stream. They are typically purchased with a single payment, and the distribution period usually begins within a year of the purchase.

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Deferred annuities may be purchased with a single lump-sum premium payment, or with a series of periodic payments. The distribution period begins some time in the future, which allows any earnings to grow on a tax-deferred basis. However, you may be able to make withdrawals at any time, as we'll discuss later.

There are different types of deferred annuities as well.

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