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Lower interest rates have spilled over into banks, and one-year CDs paying 1.5% or less are commonplace. This is a huge decline from a year or two ago when comparable CDs were paying more than 3%. With CD rates marching in an unclear direction, you may be uncertain about how to keep your income at the level you need and still get the security you have with FDIC. Keep these points in mind: your new rate a year from now may be higher or lower, and CD interest is subject to income taxes. Before you renew that CD with the ridiculously low rate, consider another alternative that offers a guaranteed income stream, with safety, AND can leave you with more money.

In what follows, taxes of 25% are assumed and an investment of $100,000 is used. The 1.5% bank CD earning $1,500 annually provides you $1,125 “take home income” after taxes. Thus, your after-tax interest rate is only 1.125% with the rest being paid to Uncle Sam in taxes. Of course, a lower tax bracket means your earnings will be higher, and vice versa. You can substitute your tax bracket and adjust the results accordingly. Let’s use a recently introduced technique called an “Income Annuity” (a garden variety deferred annuity equipped with a guaranteed life income rider) to see if we can improve on the results. But first a word about annuities!

Annuities are issued by insurance companies and, by courtesy of the U.S. Congress, enjoy income tax deferral: meaning no income taxes are due until the earnings are actually withdrawn. Insurance companies are some of the world’s largest, oldest and financially strongest companies: you use them to safeguard your life, health, home, business, car and virtually everything else you value. Annuities are broadly classified as “variable annuities” and “fixed annuities”. Variable annuities are nothing more than mutual funds inside an insurance company “wrapper” to give them taxdeferred status and, as such, their value is determined by the ups and downs of the stock market. In other words, variable annuities have risk of loss, because the stock market can lose substantial value from time to time – witness 2007/2009 when many variable annuities lost over 50% of their value. In fact, the stock market’s last high was in October of 2007 and currently is about 5,500 points short of that high water mark. Fixed annuities, on the other hand, are guaranteed by the insurance company to not lose value if they are held to maturity; thus, they are more conservative and we’ll use them since most retirement-minded investors are risk averse.

There are numerous ways that fixed annuities credit interest, but that is a discussion for a later time. Suffice it to say that if you hold a fixed annuity until maturity, you’re guaranteed to earn a minimum stated rate of interest regardless of what happens to interest rates or stock market indexes. Of course, you have the opportunity to earn a rate higher than the guaranteed minimum. Unlike the bank CD where interest is subject to income taxes even if you don’t withdraw it, interest from an annuity is not taxable until it is actually withdrawn. If you take this tax deferral feature and add an Income Annuity, you have the opportunity to maintain your “take home” income and have more later. Let’s illustrate with an example.

Let’s take most of that $100,000 and buy an Income Annuity. Back in 2007 you were probably making 5% interest on your CD and you got used to that $5000 of pre-tax income. We are going to set up an annuity designed to pay you <u>more</u> than $5000 annually AND we can set it up for LIFE. Now here is a special note... since you are used to receiving the $5000 each year from your CD, we are going to hold out $5000 from the $100,000 to cover your income during the first year of the annuity policy. This will leave $95,000 to deposit into the annuity. Don’t worry, we will make it all back during the first year. The annuity will include two very important features – a 5% cash bonus AND a <u>no-cost</u> life income benefit rider. Without boring you with the details, you can start taking your guaranteed lifetime income any time after the first anniversary of the policy. For a 59-68 year old, depositing $95,000 into this annuity with a 5% cash bonus and starting the income exactly one year after purchasing the annuity, the income will equal NO LESS THAN $5,236.87 per year... an increase of 4.7%! Imagine never having to shop for CD rates again or ever having to worry about adjusting your lifestyle to fit the movements of some banker’s whim! Annuities can readily deliver that “sleep insurance” we all desire so much!

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