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Immediate vs. Deferred Annuities

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The terms immediate annuity and deferred annuity simply indicate when the distribution phase of the annuity begins. Both allow unlimited contributions, and both can provide, upon election, a continuous stream of payments for life.

Immediate annuities

Immediate annuities allow you to convert a lump sum of cash into an income stream. They differ from deferred annuities in that they do not have an accumulation period. They are funded with a single lump-sum payment rather than with a series of premium payments. An annuity option is chosen, and the distribution period begins within 12 months after the purchase.

Immediate annuities appeal to those investors who want an investment return that they cannot outlive. The distributions are considered partly a return of the original investment and partly earnings. You are taxed on the earnings portion only.

Immediate annuities are also used to provide benefits from a terminated defined benefit pension plan. In this situation, the accrued benefits under the plan are determined for each plan participant, and a single premium annuity may be purchased for each plan participant, with benefits usually starting at age 65.

Another common use is in the structured settlement of lawsuits. In these cases, the parties agree to pay a sum of money not as a lump sum but as a series of payments, often for the life of an injured party. A monthly amount to be paid is agreed to by the parties, and an annuity is purchased that provides that amount.

Deferred annuities

With a deferred annuity, you make a lump sum or a series of premium payments and defer the payout until some time in the future. This is known as the accumulation period. The earnings in the annuity are not subject to taxation until distributed.

Deferred annuities can provide an attractive investment supplement to IRAs and qualified pension plans such as 401(k) plans.

Note: Annuity guarantees are subject to the claims-paying ability of the annuity issuer. Annuity distributions made prior to age 59½ may be subject to a 10% federal tax penalty unless an exception applies.

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