

# Understanding the Annuity Advantage

The possibility of tax deferral and guaranteed income for life are reasons why annuities are often the cornerstone of a retirement income plan. Generally, annuities pay a good rate of return, are extremely low risk, and can compliment other retirement incomes.

There are two types of annuities – "life" and "term certain." This article focuses on life annuities, which might be right for you if:

- you want a fixed income guaranteed for life
- you don't want to make investment decisions
- you want to lock in your investments at current rates
- you're not concerned about leaving an estate to your children

## What is a life annuity?

Sold only by life insurance companies, life annuities provide you with a regular income paid at selected intervals (monthly, quarterly, semi-annually or annually) for the rest of your life. Payments can be level or indexed at a pre-selected rate. Several factors, including current interest rates, are considered when an annuity income is calculated. As a result, once you buy a life annuity, you are locking an interest rate in for the entire payment period. At death, no value is available to your beneficiaries unless you arrange for a joint annuity or a guaranteed minimum payment period.

## Registered or non-registered

Assets in any registered retirement account, including your registered company pension plan, can be used for your life annuity. The entire amount of the income you receive will be taxable in the year you receive it.

Any money you have in an unregistered account may also be used to purchase a life annuity. The taxation of payments from a non-registered annuity can be quite favorable. Non-registered funds can be used to purchase a "prescribed" annuity. When you do this only the interest portion of the payments are taxable and this interest portion remains level throughout your lifetime. This results in a very favorable after tax income. A suggested strategy would be to consider using cash that is in an account and earning taxable interest to purchase a prescribed annuity. The resulting after tax cash flow will be substantially greater. If you wish to ensure that the original capital you put into the annuity is available to your beneficiaries (remember the annuity stops at your death) then you can life insure this capital. In most cases, even after the cost of insurance is paid, the remaining after tax income is significantly greater.

## Which annuity is right for you?

There are different types of life annuities. "Single" life annuities pay you an income at the selected intervals for as long as you live. "Joint" life annuities pay an income for as long as two people live, and



the income stops at the second death. Typically you would select a Joint life annuity to be sure you and your spouse would receive income for life. In fact, current pension legislation requires that if you are married and are selecting an annuity income from any registered pension plan, you must select a joint annuity with your spouse. The only exception to this would be if your spouse "signs off" and allows the payments made for your life only. In most cases it would not be in the best interest of either spouse to sign off as this effectively "disinherits" the survivor. Joint life annuities can also be arranged to pay the original amount, or a percentage of the original amount, to your spouse after your death. Typically this would be 50, 60 or 75%.

You can also purchase an "impaired" annuity. Similar to the effect poor health has on life insurance, in that it increases the premium you pay, the effect of poor health on life annuities will be to increase the income you receive (likely over a shorter period of time).

## Guarantees

Some people worry that they will buy an annuity, die shortly afterward, and all their capital will be lost. In order to protect you against such a loss, you can add a minimum guarantee to the payment period. This can usually be any five-year period up to 20 years or until a specific age (not exceeding age 90).

Example: If you add a 10-year guarantee to a single life annuity and die in the 3rd year, the remaining 7 years of payments will be commuted to a discounted lump sum and paid to your beneficiary.

Adding features, such as guarantees and survivor benefits, to your annuity reduces the income you receive, but they can provide peace of mind. Be sure to review several quotes with these various alternatives. This allows you to see the resulting incomes, and help you select the correct annuity, based on your income requirements, balanced with your desire to leave an estate for your beneficiaries.

Your **life insurance licensed** ScotiaMcLeod Investment Executive will be happy to help you shop various companies and review the results with you to ensure you're making the most suitable annuity choice.

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