

## How to Increase Your Spendable Income if You Own a CD

Contributed by Robert D. Cavanaugh, CLU  
Wednesday, 31 January 2007

Here is an example typical of many people. Mary is 75. She is a conservative investor. She has to be because she has a limited amount of capital. On the one hand, she has to play it safe; on the other hand she needs to get as much income out of her assets as she can.  
{mosbotwordcount}

There are several ways to squeeze more income out of a given amount of capital invested in a CD. Let me share with you the split annuity concept.

{bot\_wrgoogle}Here is an example typical of many people. Mary is 75. She is a conservative investor. She has to be because she has a limited amount of capital. On the one hand, she has to play it safe; on the other hand she needs to get as much income out of her assets as she can.

She has a \$100,000 5 year CD down at the bank. It is paying 4.87% interest a year. Given her objectives of earning the most she can, not taking any risk of losing the principal and her concern for the fact that prices at the grocery store keep going up, she has at least two problems.

The first is the fact that the interest on her CD is taxable. In her 15% bracket, 4.87% nets out to 4.14%. Second, her \$100,000 is not growing, so her income is not keeping up with the increases in the cost of living.

Can Mary do better?

Most likely she can. She can increase her after tax spendable income without risking her principal pretty easily. She might even be able to increase her \$100,000 over time to boot. One of the ways is by using a split annuity.

The concept behind a split annuity is simple. Mary transfers her CD to an insurance company's split annuity contract. The \$100,000 is split into two accounts. The first is an immediate annuity. This pays Mary a monthly income. The balance of the \$100,000 is put into a deferred annuity which grows at interest. Let's take a look at each of these accounts in more detail.

The advantage of the immediate annuity portion is that it can pay Mary a higher income than her CD. Second, unlike her CD, which is all taxed, Mary will pay no tax on a percentage of the income produced by the immediate annuity portion of the split annuity. Assuming a ten year payout, the amount excluded from tax could exceed 80%.

The benefit of the deferred annuity portion is that it grows tax-deferred. This part of the split annuity is designed to grow the total account back to the original \$100,000 at the end of the chosen time frame. The net result is more income for Mary without increasing her risk.

That is the basic premise of a split annuity. This assumes using one insurance company's product: a self-contained split annuity contract.

However, my experience is that you can do better if you use two insurance companies. By shopping around, you can find an immediate annuity that pays more than the immediate annuity portion of a single split annuity policy. Similarly, you usually can find a deferred annuity that pays more than the deferred annuity portion of a standalone split annuity contract. So don't just stop with having your financial planner go grab a split annuity off the shelf. Have him or her find the most competitive immediate annuity and the most competitive deferred annuity and "make your own" split annuity.

The other advantage of using two products is that some companies offer what's called a "bonus" annuity. To attract your business, they will give you a bonus for moving your money over to them. The amount is a function of interest rates and the length of the deferred annuity; in general, it can range from 5% to 10%. But the key is that the bonus is paid up front, so you earn interest on both the money you put into the deferred annuity and the bonus right from the get go.

As you have seen above, the plain vanilla split annuity is designed to have you wind up with the same amount of money you started with, but with more spendable income during the annuity time frame. Using a two insurance company approach and a bonus annuity, you could end up with more spendable income and more money. Put these two facts together and it makes the split annuity approach even more attractive.

But can we do even better for Mary? Possibly, yes, if she is willing to take a modest risk.

This alternative would place the deferred annuity portion into an equity indexed annuity. This is a subject all to itself, but let me simplify the definition of an equity indexed annuity by saying that it is an annuity where interest is credited according to the performance of one of the major stock indexes, such as the S&P 500. The annuity can only go up; it cannot go down. If the S&P 500, for example, goes up, the account goes up. If the S&P goes down, the account stays the same. There are some equity indexed annuities that also pay a bonus up front.

If Mary were to choose this alternative, she might be able to end up with an account that is worth more than her original \$100,000 at the end of whatever time frame she chooses.

I hope you take away at least two points from this article. First, for the many people who are in Mary's situation (own a CD and need more income), investigating how a split annuity might produce more income would be a smart move. Second, there are a lot of variables that have an effect on whether or not a split annuity is the best solution.

That's why there are financial planners. Sit down with one; explain your situation and objectives. Maybe a split annuity will fit the bill.

Article Source: [www.webraydian.com](http://www.webraydian.com)

Robert D. Cavanaugh, CLU is a 36 year financial and estate planning veteran and author of the free newsletter, "The Estate Preservation Advisor". To subscribe and get the free video, "How to Sell Your Life Insurance Policy for More Than the Cash Value", go to

<http://theestatepreservationadvisor.com/freevideo.htm>