SPIA's and SPDA's

There are certain occasions where a tax-free structured settlement is not possible. Perhaps the case does not involve physical personal injuries or you have already received the settlement proceeds. For these situations, two types of tax-advantaged annuity products should be considered.

The first annuity product is a Single Premium Immediate Annuity (SPIA pronounced "spee-uh"). SPIA's can provide payments for either a period certain or lifetime basis. Lifetime annuities can be written with or without a period certain feature. Annual Cost of Living Increases (COLIs) are available. Payments must commence within one year of funding. Provided funds going into the annuity were tax-free under IRC Section 104(a)(2), annuity payments are tax-preferred when received. As such, a portion of each payment is taxable and a portion is tax-free. This tax-free portion as a percentage of the total payment is referred to as the exclusion ratio. The exclusion ratio is calculated by the annuity carrier and varies depending on the payment schedule and life expectancy of the annuitant (for lifetime payment plans). SPIA's have no cash value.

The advantages of a SPIA are similar to those of a structured settlement annuity. SPIA's provide protection from reinvestment risk, mortality risk, and dissipation risk. The rate of return is similar to that of other safe investments. The exclusion ratio is additionally attractive.

The other tax-advantaged annuity product is a Single Premium Deferred Annuity (SPDA). As the name implies, SPDA's accept a single premium deposit. Generally, funds may be withdrawn from the SPDA at any time, but are usually limited to once per year and ten percent of the account value without incurring penalties. The advantages are that you can defer paying income tax, enjoy compounded growth, and retain liquidity. At any point in time, the annuitant can also elect to annuitize their SPDA into a SPIA SPDA's come with initial interest rate guarantees of various duration. Renewal rates are subject to market conditions. Most SPDA's offer minimum interest rate guarantees. SPDA's can be fixed interest or variable interest. Variable SPDA's yields are tied to equity markets or indices.

Fixed-interest SPDA's are excellent products for unneeded cash. Sales of SPDAs and SPIAs have increased dramatically in recent years with concerns about the equity markets, the longevity of the aging population, and the loss of other tax-advantaged opportunities.

Not all structured settlement specialists have experience with these products.