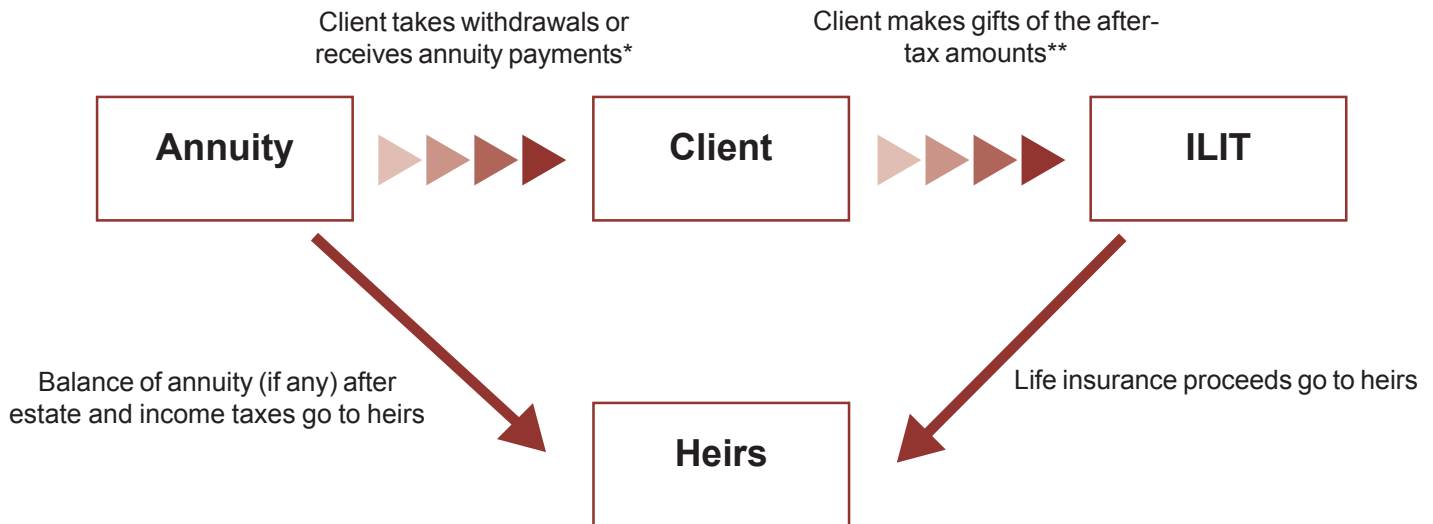


Annuity Funded Life

(A Method of Purchasing Life Insurance)



What is Annuity Funded Life?

Many clients hold deferred annuities that they will never tap for retirement. Even with market fluctuations, many of these clients may have annuities with meaningful appreciation that they hope to someday transfer to their children or heirs. However, these clients and their heirs may see large portions of their annuity values eroded by taxes – first, by the client’s estate tax and, later, by income taxes when annuity gains are taxed to the heirs. For some clients, this erosion may consume 70% or more of an annuity’s value. **This is often called the “Double Tax” problem.**

Many clients are unaware of this tax erosion issue and the impact it will have on their heirs. However, by combining their existing annuity with life insurance, clients can boost – often significantly – the benefits available to their heirs.

How does annuity funded life insurance work? Here are the steps a client would follow:

1. Clients withdraw funds from their annuity. They can annuitize their annuity contract(s), but more often clients elect to take withdrawals.
2. Clients should set aside funds for taxes on the annuity distributions.
3. They would then make gifts of the after-tax amounts to their heirs, or an irrevocable life insurance trust.
4. The gift recipient(s) would use the funds to pay premiums on a life insurance policy, typically on the life of the client or a couple.
5. On the death of the client, the life insurance proceeds will be received free of income taxes and estate taxes.*

These death proceeds can potentially enhance the annuity value and provide the heirs with far more than they would have received if the client did no planning.

Note: This strategy is for clients who currently own deferred annuity contracts. For other clients, please review our “Muni Max” presentation. With Muni Max, assets (other than annuities) are sold and reinvested into a single premium immediate annuity. Income from that annuity is then combined with life insurance for an overall more powerful approach, than retaining the current assets. With the Muni Max strategy, care must be taken not to simultaneously purchase the annuity and life insurance products from the same insurer in order to avoid tax complications.

Annuity Funded Life (Using Life Insurance)

Classic Case

Fred and Betty are a retired couple. They have a very comfortable lifestyle and receive the vast majority of their retirement income from a pension, Social Security, their IRAs and dividends from their portfolio. Years ago they purchased several deferred annuities to help fund their retirement. They have been very happy with the annuities' growth but they now realize that they will not need them for their living expenses.

The couple is happy with their annuities and they would like to transfer them to their two children after their deaths. After discussing their needs you explain to the couple the tax erosion problems that these annuities face. While it made sense to purchase these annuities years ago, if the couple does not plan to tap them in retirement, they need to do additional planning for these assets. You show them how they can adopt an annuity funded life program to obtain their objectives.

By taking small distributions from their annuity each year and using the after-tax funds to purchase life insurance owned outside of their estate and paid for through gifts of the annuity distributions, the couple is able to transfer more to their children than they might have otherwise transferred without planning. Although the couple pays taxes on their annuity distributions each year, earnings on their deferred annuities would have been subject to income tax sooner or later. They can now use those after-tax amounts to purchase life insurance, which if owned properly, can be received by the family free of income and any estate taxes.

How is Life Insurance Designed for this Approach?

Any type of permanent life insurance is appropriate for this concept. Where both spouses are alive, clients might

obtain better tax leverage through the purchase of second-to-die life insurance coverage. However, either single life or survivorship is appropriate depending on the circumstance. Term life insurance is generally not used with this concept as it is important the coverage remain in place until death, not just for some limited term.

In designing the life insurance policy you should have a sense as to the amount that would be distributed from the annuity and the after-tax amount that it will generate. This determines the premium for the life insurance policy. This concept works best where the death benefit, based on the distribution stream the annuity provides for a greater amount to the heirs than if there was no planning. To the extent the after-tax annuity distribution can purchase even larger amounts of life insurance, the concept is even more advantageous.

What Will My Clients Ask Me?

- **What is the Double Tax?** At a client's death, most assets receive what is known as a step-up in basis. This step-up increases the asset's cost basis, for the heirs, to the value on the date of the client's death. The effect and benefit of this is that heirs can sell the asset at reduced or eliminated capital gain taxation. This step-up in cost basis is often central to estate planning for certain assets.

Certain other assets – called income with respect to a decedent (IRD) assets – do not receive this step-up in basis. These assets are ones that enjoyed tax-deferred appreciation during a client's lifetime – qualified plans, IRA accounts and annuities. Because of this lack of a step up in basis these assets often face what is called double taxation—first at the client's death and then income taxed in the hands of the heirs.

This lack of a step-up in value for these IRD assets offers planning opportunities for those clients who do

Who is the Ideal Client?

The typical client will already own one or more deferred non-qualified annuities that have appreciation and are expected to grow. These will typically be clients with:

- Sufficient assets to support their living expenses and will not need their annuity(ies) for income,
- A potential estate tax problem. While this concept will work for clients without estate tax issues, the tax erosion at death is more dramatic where there is an estate tax liability.

An ideal client will have a net worth over \$3,000,000 and be age 60 or older. This sized estate is where a client's assets are large enough that, even with reasonable growth, there would be some level of estate tax. Lower net worth clients are more likely to need their annuity funds during their retirement years. As a result, an annuity funded life approach would be less appropriate for these clients. Also, clients younger than age 59 ½ may face additional current income taxes on distributions from their annuities.

Any size life insurance policy and design might be utilized with this concept, but the funds coming from the annuity should generally be large enough to generate a death benefit sufficient to replace the lost annuity value. This will assure that the annuity is removed from their estate and its value is replaced in the hands of the heirs. To the extent the annuity withdrawals can support larger death benefits, this concept is even more attractive.

not need these assets for income and will not spend down these assets in retirement.

- **Why is the double tax high, but not the sum of the client's tax bracket?** If a client is in a 50% estate tax bracket and the heirs are in a 40% income tax bracket, the erosion is less than the 90% of these two combined brackets. The reason is a deduction allowed against the heir's income tax. That deduction is equal to a portion of the estate taxes paid by your client. Each year income is received from the annuity, the heirs receive an itemized deduction equal to the pro-rata amount of estate taxes levied on that portion of the annuity. The net effect is to trigger erosion of the annuity value at a rate somewhat less than the combined rates.

- **How much life insurance do I need?** Any type of life coverage is appropriate. You and your clients can determine, based on your client(s) risk tolerance, and health whether they are best suited for a universal life or variable universal life contract, single life or second-to-die contract. Simply put – the healthier the client(s), the more death benefit that can be purchased, allowing for a greater benefit from the annuity funded life insurance policy.

- **I am told that my annuity has a death benefit rider. Why would I still need to look at this approach?** Many recent annuity contracts contain special death benefit increases. These generally fall into one of two types, described, below. However, even with these riders, clients will still see erosion in the value of their annuity value when transferred to their heirs. They should still consider this Annuity Funded Life approach.

Death Benefit Reset – it is common for annuities to reset their value periodically for death benefit purposes. This reset value increases any death benefit payable to heirs on the death of the annuity owner. Typically, these reset features are offered to long-term investors in variable annuity contracts to assure that they do not lose the benefit of appreciation. However, these reset options are subject to all of the same estate taxes and income taxes levied on these double tax assets. This death benefit rider merely takes away the “sting” of the taxes.

Estate Tax Rider – some recent annuity contracts attempt to negate the impact of the double tax by offering a rider designed to increase the annuity value, at the owner's death, by some portion of the estate taxes. This rider comes with an added cost. If your annuity does not have this rider, it generally cannot be added. Even if your annuity has this rider, you should still consider the Annuity Funded Life approach as all the benefits (including those paid under this rider) are still subject to the heir's income tax and may not cover all estate tax erosion.

- **Why can't I just gift the annuity out of my estate?** The Tax Code discourages this. Unless the transfer is to a spouse (which doesn't often advance estate planning objectives) any gain in the annuity is immediately taxable to the former owner, in the year the gift was made.
- **Can life insurance policy cash values be used for my family?** If the life insurance is owned by a trust, the policy cash values would be treated as any other trust asset. Depending on how the trust is written, the life insurance policy cash values can be distributed to the family. However, any distribution of life insurance cash values may affect the death benefits available to the family.
- **Why would my client intentionally expose their annuity earnings to income taxes today?** Although this may be counterintuitive, these funds will be income taxed eventually. Withdrawing some amounts today, and applying the after-tax amounts toward gifts for life insurance premiums, potentially provides heirs with much more than might have been received from the annuity without the additional planning.
- **Why is the presentation showing withdrawals from the annuity? Wouldn't it make more sense to annuitize?** Many clients prefer not to annuitize when working with this concept. By taking withdrawals a client can maintain maximum flexibility – taking more or less each year from their annuity as conditions merit. While some annuities offer re-election options related to their payout amounts, taking withdrawals allows for flexibility without the paperwork and election deadlines that often accompany a reset feature. Moreover, taking withdrawals allows the amounts remaining in the annuity to continue to grow tax deferred. Finally, at a client's death, the heirs can receive both the death benefit from the life insurance contract and any funds remaining in the annuity, after the double tax on the remaining amounts.

Nevertheless, annuitization offers some benefits. These include shifting some risk back to the insurance company to assure payments are made on a regular basis. Also, typically each annuity payment is only partially taxable as income (through a calculation called an exclusion ratio). By contrast, amounts taken as withdrawals are often 100% exposed to taxation as earnings are deemed to be withdrawn prior to any return of principal. In some cases, particularly at the older ages, annuitization may make more sense clients can often lock into higher after-tax payouts and the need to maintain flexibility in the amounts received from the annuity may be less significant than the higher payout.

Travelers Life & Annuity Support for this WebStory Concept

WebStory Client Presentation:

This is a supplemental illustration that works in conjunction with an underlying basic life insurance illustration. It is a client oriented presentation that extracts key numbers out of the life insurance illustration and creates an easy to understand report, written in plain English, that discusses this concept in words, pictures, flow charts and the client's own numbers.***

Building and Preserving a Legacy

Building Financial Security
Financial security for you and your family generally comes through hard work and a well-managed investment portfolio.

Despite your diligent efforts, taxes can be one of the greatest obstacles to achieving your financial objectives. In response, you may have invested in tax-deferred assets as part of a plan to minimize the effect of current taxes on your investment results. In fact, many financial advisors view tax-deferred savings vehicles such as IRAs and tax-deferred annuity contracts as the cornerstone of a sound retirement savings plan.

Preserving and Transferring your Legacy
As you approach retirement you may find that your tax-deferred savings exceed your needs. In fact, you may find that you have accumulated more than enough wealth for your retirement in a variety of forms such as qualified retirement plans and annuity investments.

As your circumstances have changed, you may find that you no longer need many of these assets for retirement income, but instead plan to leave them to your heirs. You may be thinking about your legacy.

Again, taxes can be a major obstacle to achieving your objectives. In fact, the combined effect of estate taxes and income taxes can significantly diminish the value of your assets that are ultimately transferred to your heirs.

Annuity Funded Life is a planning approach involving the use of existing annuity contracts and life insurance. It is one strategy that you may want to consider to attempt to help you preserve your legacy and to pass more of what you worked so hard to achieve on to your heirs.

Benefits of Implementing the Annuity Funded Life Plan

- With proper planning, life insurance proceeds can be paid to your heirs free of income and estate taxes, fully preserving the value of your annuity and other assets passing to your heirs.
- Your life insurance liquidity needs can be fully or partially funded with the net after-tax distributions that you receive from your annuity contract.
- By reducing the value of your annuity contract today through withdrawals or annuity payments, you can reduce, and possibly even eliminate, estate taxes and income taxes on the annuity at the time of your death.

References to annuity values are hypothetical and are not intended to represent the performance of any particular annuity product. They are included solely to illustrate the potential benefits of the Annuity Funded Life concept.

This is a supplemental illustration designed solely to illustrate a concept and is not valid without a basic complete illustration for the life insurance policy described. NOT VALID WITHOUT ALL PAGES.

Concept Supplement Page

Annuity Funded Life Fact Finder (Using Life Insurance)

Please work with your financial advisor to complete this fact finder. They will work with their life insurance design specialists or the Travelers Life & Annuity Internal Sales Support Desk to develop a life insurance illustration and a presentation on this concept that is customized to your situation.

Client Information

Name(s) _____
 Address _____
 City, State, Zip Code _____
 Phone _____ Mobile Phone _____

Advisor Name: _____
 Advisor Company _____
 Advisor Office Address _____

Advisor e-mail _____
 Advisor Phone _____ Advisor Fax _____

Life Insurance Information

Client's Birthdate: _____ Health Status: _____ Smoker? (N/Y) _____
 If appropriate, Spouse's Birthdate: _____ Health Status: _____ Smoker? (N/Y) _____

What type of coverage is required?
 survivorship coverage insuring both lives
 single life coverage insuring client's life
 single life coverage insuring spouse's life

How much Death Benefit is required? _____ level _____ increasing

How will premiums be paid?
 level premiums for life
 level premiums for _____ years
 level premiums for minimum years possible

Note: This WebStory presentation is designed to automatically show withdrawals from the annuity sufficient to pay the annual premium. It does not amortize the contract. Where the annuity values are not sufficient to cover the premium payments, the presentation shows the need for clients to contribute other assets.

Information Needed to Present this Concept to Clients

Current Annuity Balance: \$ _____
 Investment in the Contract (basis): \$ _____
 Assumed Annual Earnings Rate: _____ %

The impact of this concept will vary based on both appreciation in the annuity and client tax rates. Tell us about the tax rates.
 Estimated Estate Tax Rate: _____ % Estimated Income Tax Rate: _____ %
 Estimated Income Tax Rate for Heirs: _____ %

This information is important to examine the tax impact of no planning.
 Is this annuity contract to be used to provide retirement income? _____ yes _____ no
 (If yes, annuity funded life is probably not suitable for your situation)

The presentation shows the cumulative effect of implementing an Annuity Funded Life concept at selected points of time in the future. What future year do you want to target? _____

L-16696-cl 07/03

Client Fact Finder

Use L-16696-cl Client Fact Finder.

Other Supporting Materials

Sales Solutions (L-20926), Financial Strategies (L-16526), and the Producer Website are among several tools Travelers Life & Annuity has available. Many of these are available for this concept or related to this concept. Also available is a Model Client Pre-Approach Letter. This is a letter designed to entice your client to call you about this concept.

Sales Solutions

TRAVELERS LIFE & ANNUITY ADVANCED MARKETS

Family Limited Partnership as an Alternative to

Many of traditional estate planning is centered on the Internal Revenue Code (IRC). Under the typical approach the client purchases the insurance and pays premiums with after-tax dollars. From 1981 to 1986, the client could purchase the insurance through a trust. This trust could be structured to provide for the client's needs during their lifetime and to provide for the client's heirs after they pass away.

The ability to transfer the ownership of the insurance to a trust can provide for the client's needs during their lifetime and to provide for the client's heirs after they pass away. This trust can be structured to provide for the client's needs during their lifetime and to provide for the client's heirs after they pass away.

Financial Strategies

TRAVELERS LIFE & ANNUITY ADVANCED MARKETS

Buy-Sell Agreements

A Buy-Sell Agreement (BSA) is a contract between two or more parties that provides for the purchase of a business interest in the event of the death or disability of one of the parties.

Advantages:

- BSA can "buy" the share of a business interest for a fixed price.
- BSA can provide for smooth and business succession.
- BSA can provide for liquidity and estate tax planning.

How to Work:

- Business interest must be purchased by the business.
- BSA can be an individual purchase life insurance or a business interest.
- Business interest must be purchased by the business.

Producer Website

Family Income Plan

The Family Income Plan is a concept designed to help clients protect their existing assets and family from an untimely death. This presentation shows the benefits of the insurance and the added benefits of placing the insurance into a trust. It explains the benefits to family, how to structure the trust, and how to use the trust to provide for the client's needs during their lifetime and to provide for the client's heirs after they pass away.

Key Features:

- Flexible Premiums
- Flexible Death Benefit
- Flexible Withdrawals

*Annuity withdrawals made prior to age 59 1/2 may be subject to an additional 10% excise tax. Withdrawals from some annuity contracts may be subject to surrender charges. Review any annuity contract carefully before making withdrawals.

**Gifts, in some cases, may be subject to gift taxes.

*** Because this is a supplemental illustration it must be accompanied by a complete basic illustration. If a variable product is shown, it must also be accompanied by a prospectus. All examples used in this marketing piece are purely hypothetical and do not reflect any specific financial products. The amount of life insurance death benefit available will depend on many factors, including your client's age, health and insurance capacity. Your client's results will be different from the examples presented.

Important Notice: The foregoing discussion involves complex tax and legal issues. This discussion is not a legal opinion, it is only meant to provide guidance. Any decisions whether to implement these ideas should be made by the client in consultation with professional tax and legal counsel. Life insurance products are issued by The Travelers Insurance Company, or The Travelers Life and Annuity Company, One Cityplace, Hartford, CT 06103-3415. The principal underwriter is Travelers Distribution LLC. For more information about the variable products, including fees and charges, refer to the prospectus. Guarantees are backed by the financial strength of the issuing company. Investments in variable life insurance products are subject to market risk including the loss of principal.



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