Deferred Annuity Plans: 4 Things To Keep In Mind To Avoid Getting Mis-Sold

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A deferred annuity is a contract with an insurance company to receive either a regular income or a lump sum amount after a certain period or on a specific date in the future. Usually, most policy buyers use it as a means to supplement their retirement income. While immediate annuities are the ones that start paying you right away, deferred annuities are different in that context.

A deferred annuity is designed specifically for long-term savings. It is an insurance contract that doesn't start paying you immediately.

Buyers can also indefinitely delay the payments, though, during this time duration, the earnings on it are tax-deferred. One can also increase the annuity's value by adding funds to the account. One advantage they offer is that you can withdraw a lump sum amount from it whenever you need it.
It is also possible to transfer the annuity to any financial institution or withdraw it, if possible. The insurance company allows you to easily convert the annuity into a stream of payments at a certain date in the future. Over time, you will earn interest on the assets that are present in the annuity. However, you need to pay fees or taxes for each option.

An agent selling you 'deferred annuities' might not clearly tell you everything about the product though. As such, you could well end up with a product that does not quite align with your needs.
While these products are meant to ensure good income generation post retirement, there could also be instances of mis-selling, like padding up the returns, not informing annuities are taxable, and so on. High commissions on such products are also a reason for agents mis-selling them to gullible buyers.

Hence, if you are buying deferred annuities, here are the things to keep in mind.
Annuities are taxable: According to Vishal Dhawan, CEO and founder, Plan Ahead Wealth Advisor, and a Securities and Exchange Board of India (Sebi) – registered advisor, annuities are taxable and thus, the cash flows from annuities may not be very tax-efficient.

Under Section 80CCC of the Income-tax Act, 1961, you could claim a maximum deduction of Rs 1.5 lakh per annum for deposits you make into an annuity plan from a life insurance company.

However, the taxation on withdrawals is at the normal tax rate, depending on the slab you are in.
Says Arijit Sen, co-founder, Merry Mind, and a Sebi-registered investment advisor: "Although, a portion of deferred annuity which is commuted, is tax-free, the pension amount is taxable as per the tax slab at the time of vesting age. Therefore, you need to figure out if deferred annuity (purchased) will be an ideal retirement-solution during one's vesting age, because of the impact of inflation and income tax."
Inflation is the culprit: It is important to remember that inflation will continue during the retirement years too, so it needs to be factored in before buying one of these annuity plans.

Says Dhawan: "The annuities are not inflation-adjusted, and so the values that you get from the annuity may not be sufficient to help you meet your cash flow needs when you retire, as expenses will keep going up due to inflation."

Mind the pay-out option too: There are various payout options available under a deferred annuity plan. For instance, an annuitant can choose to receive an annuity for life or an annuitant can choose to receive an annuity for a limited period.

“Annuity payable for life with return of purchase price on death along with other options are also there for the annuitant to choose from. The payout option must be selected very diligently based on one’s needs. It depends upon the retirement phase, family structure, and financial scenario, etc,” adds Sen.
Keep IRR in mind: When you are buying a deferred annuity product, you should ideally keep in mind the concept of internal rate of return (IRR), as it will help you determine profitability.

When you calculate the IRR, the present value or the net value of future cash flows is taken as zero. “Considering that the time value of money is critical, inflation means that the same amount of money received in one year is not equal to the money received in another year in the future, as it may not be able to buy the same amount of goods and services. IRR ends up reflecting this time value of money,” says Dhawan.

However, as a lot of people don’t understand the concept of IRR and end up speaking in absolute numbers. Annuity buyers find it difficult to relate it to the time value of money and current discounted values.