Variable Annuities in an IRA, The Argument Against
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Each side of the argument for and against variable annuities in IRA's has its predictable defenders. Insurance companies (Mass Mutual, Jackson) think that variable annuities in IRA's are fine. Consumer advocates and protection agencies (SEC, FINRA) think, at a minimum, people must be more informed about why they are choosing variable annuities. No surprises there. So what are the objections to putting a variable annuity in an IRA?

Is two always better than one? Not when you are talking about tax deferrals

The most common objection is due to the fact that a variable annuity has a tax deferred status and an IRA is a tax deferred account. So the benefit of saving money, letting it accumulate tax-free, withdrawing the money, and paying taxes when you may reach an age where your tax bracket is less - cannot be bettered. The greatest benefit of a variable annuity (some would argue), its tax deferred status, is lost in placing it in an IRA account.

Charges for withdrawals

So what? You duplicate the tax deferred benefits. Silly, but harmless. Well, not so. If you invest in a variable annuity in an IRA, you lose the ability to withdraw money without penalties for certain lifetime events like medical expenses and higher education (For more examples of what events may qualify you to take a penalty free withdrawal, see SmartMoney's Tapping Your IRA Penalty Free.) A variable annuity comes with a period of years during which withdrawals incur a penalty amounting to as much as 10%.

Earnings

So an advantage of an IRA and a variable annuity is that earnings accumulate tax-free. What about those earnings? When you buy an annuity, you pay a sales charge, a mortality & expense charge, and administrative fees. Any earnings you make are diminished by those costs. Furthermore, you essentially put the money you invest in an annuity into subaccounts (more of what these are below) which carry their own management fees. A mutual fund may come with expenses, but the expenses are more numerous with an annuity.

Investment choice

Sub-accounts are similar to mutual funds. (Subaccounts will differ slightly in terms of daily price, performance, costs, fees and capital gain distributions.) However, when you invest in an annuity, your choices of subaccounts is markedly less than world of mutual funds - for example you may get a choice of 100 subaccounts versus the thousands of mutual funds on the market. Of course, you also preclude the option to invest in other types of investments allowable in an IRA like stocks.

Transfer costs

If you transfer money between subaccounts you will most likely be charged. It may cost to sell and buy a mutual fund within an IRA, but the fees will not approach what you will pay in a variable annuity. Proponents of variable annuities in an IRA argue the death benefit and lifetime income guarantee make up for the costs and limitations of variable annuities.