Genworth Financial

Exchanging Annuities and Life Insurance for Long Term Care Insurance

1035 Exchange FAQs

1. **What is a 1035 exchange?** IRC §1035 permits owners of life insurance and non-qualified annuities to exchange all or a portion of their contracts for certain related types of contracts without being taxed on any unrealized gain at the time of transfer. A life insurance policy can be exchanged for another life insurance policy or an annuity contract. A deferred annuity can be exchanged for a deferred or immediate annuity contract. Starting in 2010, both life insurance and annuities can be exchanged tax-free for stand-alone (traditional) tax qualified long term care insurance.

2. **How can an annuity be exchanged for long term care insurance?** One type of 1035 exchange is an exchange from a new or existing non-qualified annuity to pay for a tax qualified long term care insurance policy. Any gains transferred as part of the 1035 exchange to pay long term care insurance premiums would be tax free.

3. **What is a non-qualified annuity?** In the broadest sense, an annuity is a contract between an insurance company and an owner that guarantees payments to the owner for a specified period of time in return for either a single premium payment or periodic flexible premium payments to the insurance company. A non-qualified annuity is any annuity that is not a qualified annuity. Qualified annuities include annuities written or endorsed as individual retirement annuities (IRAs), Roth IRAs, SIMPLE IRAs, Simplified Employee Pensions (SEP) and 403(b) annuities – tax sheltered (TSA) or tax deferred annuities (TDA) – or as qualified retirement plan investments. A non-qualified annuity is funded with after-tax money and/or a 1035 exchange from another non-qualified annuity contract or life insurance policy, and provides tax-deferral.

4. **What is a tax qualified Long Term Care Insurance (LTCI) Policy?** A tax qualified long term care insurance policy is one that complies with Section 7702B(b) of the Internal Revenue Code of 1986, as amended by the Health Insurance Portability and Accountability Act of 1996 (HIPPA) - Public Law 104-191. Benefits received from such a policy for qualified long term care expenses may be tax free.

Long term care insurance is underwritten by Genworth Life Insurance Company and in New York, by Genworth Life Insurance Company of New York. Annuities are issued by Genworth Life Insurance Company, Genworth Life and Annuity Insurance Company and in New York, by Genworth Life Insurance Company of New York. Only Genworth Life of New York is licensed to conduct business in New York.

5. **Must my client exchange the entire annuity to get this benefit?** No, partial exchanges are permitted. In this case, gain and basis are transferred in a pro-rata fashion.

6. **What types of annuities can be used for this exchange?** Any non-qualified annuity may be used, subject to limitations set by the transferring company.

7. **Are there restrictions for Genworth Financial insurance companies' products?** Immediate or deferred fixed annuities are eligible for partial 1035 exchanges. However, contracts with restriction endorsements or irrevocable payees may not be eligible. Genworth variable annuities are not eligible for partial 1035 exchanges at this time. Full 1035 exchanges of variable annuities are acceptable, however. Variable annuities issued by other companies may be eligible, subject to the issuing company's restrictions. The issuing company should be contacted to verify eligibility.

8. **Do the 1035 rules apply to life insurance as well?** Yes, but most life insurance policies have too much cash value to be fully exchanged for a traditional long term care insurance policy, and a partial exchange (if allowed by the transferring company) may have adverse consequences on the life insurance policy. One alternative may be to exchange the life insurance policy for an annuity, and then do partial exchanges from the annuity to fund long term care insurance premiums. Another alternative may be to exchange the life insurance policy for a linked benefit product. You may contact the Advanced Marketing team to discuss your client's particular situation.

9. **My client has a variable annuity that has lost a lot of value in the past year. Would there still be a tax benefit associated with the 1035 exchange?** There is unlikely to be any tax benefit to exchanging a deferred annuity with no gain for a long term care insurance policy.

10. **Does it matter if the annuity has already been annuitized?** If the client is receiving income from an existing annuity, they may designate all or part of the income from that annuity to pay their LTCI premiums by submitting the appropriate 1035 exchange authorization form.

11. **What is the benefit from exchanging an annuity for long term care insurance?** By exchanging an annuity to pay for long term care insurance premiums, the owner may avoid taxes on the gain portion of the amounts exchanged, which would otherwise be taxable when withdrawn from the annuity.

12. **What is the value of this tax treatment?** Under federal tax law, partial withdrawals from a deferred annuity are generally taxed as ordinary income to the extent of gain in the contract. Payments from a fixed immediate annuity receive an exclusion ratio – meaning that a portion of the premium will be tax-free until all basis has been recovered from the contract. The benefit of a tax free transfer of funds from an annuity would vary based on the tax situation of the owner and the percentage of gain in the annuity. For example[1], if half the contract value of a deferred annuity is gain, then half the amount 1035 exchanged to pay a LTCI premium would also be considered gain. Because it is a tax-free exchange, though, that gain is not taxed. If a $2,000 long term care insurance premium is paid from such an annuity, then taxes on $1,000 would be avoided. If the owner is taxed at a 35% rate, then this would avoid up to $350 in taxes. This tax savings needs to be compared against any available federal tax deduction and state tax deduction or credit that the policyholder might be entitled to by paying long term care insurance premiums with after-tax money. In particular, for those who itemize, eligible long term care insurance premiums (the lesser of actual premiums or age-based limit amounts) may be deductible as unreimbursed medical expenses.

[1] This is a hypothetical example used for illustrative purposes only.

13. **How does this tax treatment affect long term care insurance premiums?** The tax savings in the example above could effectively reduce the cost of the long term care insurance by $350, or about 17.5%. If the policyholder had not used this withdrawal to pay for the long term care insurance, they would have had to pay $350 in taxes on the $2,000 withdrawal, even if they had used other funds to pay their long term care insurance premiums.

14. **If my client has recently received an annuity withdrawal, can they make a 1035 exchange by submitting a check (or endorsing the un-deposited withdrawal check) to pay the long term care insurance premium?** No, the exchange must be made in a "hands off" fashion. That is, the transfer of funds can't pass through the annuity owner's hands or financial accounts. It must occur between or within insurance companies. If proceeds from the annuity are received by the owner, they may be liable for taxes even if they later use that money to pay for long term care insurance premiums.

15. **Can more than one annuity be used?** Yes, funds from one or more annuities can be transferred by 1035 exchanges to pay LTCI premiums.

16. **How do payments for an existing LTCI policy work?** Effective 1.1.2010 policyholders can begin to make premium payments from their annuities. They must complete the required Annuity to LTCI 1035 Exchange Authorization form and submit it to the address provided.

17. **Can the sole owner of an existing annuity pay for a jointly owned LTCI policy via 1035 exchange?** No, the owner(s) of the annuity must be the same as the policyholder(s) of the LTCI policy or policies. For example, a single-owner annuity to an individually-owned LTCI policy or a jointly- owned annuity to a shared-ownership LTCI policy. Subject to restrictions in the annuity contract, the owner may be able to accomplish this exchange by changing the ownership of the annuity to match the current or expected ownership of the LTCI policies. While changing ownership of an annuity contract is generally treated as a taxable event, ownership changes between spouses are tax-free.

18. **Can a corporate-owned annuity be exchanged for LTCI?** No, only annuities owned by individuals are eligible for 1035 exchanges to LTCI policies.

19. **Can an annuity that is owned by a trust be used for 1035 exchanges?** No.

20. **How will payments be processed?** Payments for a Genworth Life or Genworth Life of New York long term care insurance policy will be handled on an annual basis and will be processed automatically each year until canceled by the policyholder. If there are insufficient funds in the annuity to make the payment in full, the policyholder will be notified and given the opportunity to switch to direct billing from that point forward. If the annuity owner is purchasing a new long term care insurance policy, the first three months' premium must be paid from sources other than a 1035 exchange. Once the policy is issued, 1035 exchanges can be used to pay ongoing premiums. If both the annuity and long term care insurance policy are administered by Genworth Life Insurance Company (or Genworth Life Insurance Company of New York in New York), we will automatically make the withdrawals and payments each year according to the owner's wishes. The annuity contract owner/policyholder may terminate this arrangement at any time by simply notifying our customer care center at 888-GENWORTH.

21. **How does it work if the annuity is issued by another company?** It doesn't matter as to tax treatment, but it may complicate the payment process. In this event, we will notify the policyholder annually when premiums are due and provide them with the 1035 exchange request forms that they should sign and forward to their annuity company. That company may also have paperwork for the annuity owner to complete. The company that issued the annuity will then transfer the funds directly to us to pay the LTCI premium. We are evaluating the inter-company payment process and expect that industry standards will develop to facilitate systematic payments. In that case, it may not require policyholder action each year.

22. **Will surrender charges be incurred during a 1035 exchange?** Deferred annuities may assess surrender charges on withdrawals in excess of certain amounts and taken prior to the end of a prescribed holding period. *If the annuity is within its surrender charge period and the amount transferred to fund a LTCI premium is greater than what is permitted under the contract's free withdrawal limit, or the annuity contract does not have a free withdrawal limit, the excess amount will be subject to a surrender charge.*

23. **How large of an annuity is needed to fund a typical LTCI policy?** There are many factors that will affect this decision, but there is no limit on annuity size that may be used for partial exchanges and still receive 1035 exchange treatment.

24. **Do New York's Reg 60 Rules apply?** The current version of New York's Reg 60 does not apply to exchanges from an annuity contract or life insurance policy to a long term care insurance policy. That situation may change in the future.

25. **Do non-qualified SPIA payments funding a long term care insurance policy qualify for 1035 tax treatment?** Yes, if the SPIA is directly funding the long term care insurance policy pursuant to an assignment. The payee for each annuity payment funding the long term care insurance policy must be the long term care insurance issuing company. Based on our interpretation of current tax law, we will report SPIA payments directly funding long term care insurance as taxable amount $0.00 (zero), unless the IRS issues instructions requiring different reporting. In order to ensure SPIA payments will match LTCI premiums upon issue, close attention must be paid to both companies' rate hold periods. It is important to understand that if the LTCI premium increases, the SPIA payment may no longer be sufficient to cover the cost of the LTCI.

26. **Can SPIA payments be split where part of the payment is used to fund a long term care insurance policy and part of the payment is sent to the owner's checking account?** Yes, but again, the insurance company issuing the long term care insurance policy must be listed as the payee for the portion of the immediate annuity payment that is funding the long term care insurance policy. Based on our interpretation of current tax law, the portion of the immediate annuity payment directly funding long term care insurance will be reported by us on a Form 1099-R, as taxable amount: $0.00 (zero), unless the IRS issues instructions requiring different reporting. Normal tax rules will apply to any portion of an immediate annuity payment that is not directly funding a long term care insurance policy and will receive a separate Form 1099-R.

27. **What forms are required to initiate a 1035 exchange from an annuity contract or life insurance policy to an LTCI policy? Contact your Genworth Representative for additional information or updates.**

Annuity Contract/ Life Policy Issuer	LTCI Policy Issuer	Genworth Forms Required (other companies' forms may also be required)
• Genworth Life • Genworth Life & Annuity • Genworth Life of New York	• Genworth Life • Genworth Life of New York	• **Deferred Annuity:** Form 42923LTC plus letter of instruction to Annuity provider. • **Life Policy:** Form 42923LIFE plus letter of instruction to Annuity provider. • **Immediate Annuity:** Form 49787 to certify payee is LTCI provider and assign applicable portion of SPIA.
Other Company	• Genworth Life • Genworth Life of New York	• **Deferred Annuity:** Form 42923LTC plus letter of instruction to Annuity provider. • **Life Policy:** Form 42923LIFE plus letter of instruction to Annuity provider. • **Immediate Annuity:** Other company's form.
• Genworth Life • Genworth Life & Annuity • Genworth Life of New York	Other Company	• **Immediate Annuity:** Form 49787 to certify payee is LTCI provider and assign applicable portion of SPIA.

28. **How will commissions be paid for new LTCI applications?** Commissions are normally paid once a full modal premium is received in the home office. Since the 1035 exchange only permits annual mode, commissions are not paid until a full year's premium is received. If an application for a new LTCI policy is submitted with a full year's premium, commissions will be paid as usual at policy issue. If the three month minimum is submitted, commissions will not be paid until the policy is delivered and accepted and the remainder of the first year's premium is received via the annuity withdrawal. This could be several months after the policy application is submitted.

29. **Can a jointly-owned annuity fund separate LTCI policies via 1035 exchanges?** No. The ownership of the annuity must be changed to match the LTCI policies and this may be a taxable event.

30. **Can a jointly-owned annuity fund a shared LTCI policy?** In most cases, this works, but the LTCI policy must truly be a shared policy (two insureds on one policy) and not two individual policies shared by a rider. The difference is determined by the number of premium invoices received. If the shared policyholders receive one premium invoice, then this is a shared policy with two insureds on one policy. If they receive two separate invoices for their premiums, then this is not a true shared policy. A jointly-owned annuity can only fund a true shared LTCI policy. The individual LTCI policies shared by Rider must be funded from individual-owned annuities.

Important Information: The Genworth Financial companies developed these FAQs to help you understand the ideas discussed. Any examples are hypothetical. They may not reflect your client's particular circumstances. Your clients should carefully read their contract, policy and prospectus(es), when applicable. What we say about legal or tax matters is our understanding of current law. We are not offering legal or tax advice. Tax laws and IRS administrative positions may change. We did not develop these FAQs for use in avoiding any IRS penalty and neither you nor your clients may use it for that purpose. Your clients should ask their independent tax and legal advisors for advice based on their particular circumstances. We reserve the right to change the information reporting described herein to comply with forms and instructions issued by the Internal Revenue Service.