



# New Opportunities for Funding Long Term Care Insurance Changes Taking Effect on 1/1/2010

## Pension Protection Act (PPA) of 2006 FAQs

- 1. What impact does the PPA have on long term care insurance funding starting 1/1/2010?** On 1/1/2010, the following important provisions go into effect that could have a large impact in planning for a long term care (LTC) event.

- **Linked Benefit Annuity Products:** Benefits received for covered long term care expenses are tax-free and internal LTC rider charges are not taxed as distributions.

- **Linked Benefit Life Insurance Products:** Internal LTC rider charges are not taxed as distributions.

- **Traditional Long Term Care Insurance (LTCI):** New 1035 exchange rules provide tax free options to fund a traditional LTCI policy.

- 2. What is Tax Qualified Long Term Care Insurance?** Congress passed the Health Insurance Portability and Accountability Act in 1996 to ensure that long term care insurance policies receive favorable tax treatment if they meet certain standards.

Tax-qualified long term care insurance benefits are federal income tax free and premiums are eligible for income tax deduction, subject to certain limitations.

- 3. What are the Key Changes to Linked Benefit Annuity products?**

**Prior to 1/1/2010:**

- Long term care benefit payments were taxable as distributions, to the extent of gain in the annuity contract.
- Internal charges taken from the account value for the long term care riders were also taxable as distributions, to the extent of gain.

**Key Changes Effective 1/1/2010:**

- Tax qualified LTC insurance riders under a non-qualified Linked Benefit annuity contract will be treated as a separate contract. As a result, tax qualified LTC benefits from these products are tax free.

- LTC insurance rider charges taken from the Linked Benefit annuity account value are not taxable distributions. However, these charges reduce investment in the contract, but not below zero. This may have tax implications if the contract is surrendered, or at the death of the owner.

**Genworth Financial companies include:**

**Genworth Life and Annuity Insurance Company,** Richmond, VA

**Genworth Life Insurance Company,** Lynchburg, VA

**Genworth Life Insurance Company of New York,** 666 Third Avenue, 9th Floor, New York, NY 10017. Only Genworth Life Insurance Company of New York is licensed in New York.

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- 4. Are there any changes to Life Linked Benefit Products?** Prior to 1/1/2010, internal LTC insurance rider charges are taxable if the policy is a Modified Endowment Contract (MEC) and there is gain.

Key Change Effective 1/1/2010, Tax Qualified LTCI Rider Charges are no longer treated as taxable distributions to the policyholder. However, these charges reduce basis in the contract but not below zero. This may have tax implications if the contract is surrendered. The life insurance death benefit would ordinarily be tax free.

- 5. How do Linked Benefit policies provide opportunities for my clients?** These policies provide another solution for financial professionals whose clients do not want to purchase traditional long term care insurance, but are still concerned about the impact an extended health care event might have on their retirement portfolios as well as on their families.

With regard to Linked Benefit annuity products beginning in 2010, a client would have the opportunity to make a tax-free 1035 exchange of funds from an annuity or life insurance policy with gain into a Linked Benefit annuity product. The client can leverage the amount of premium dollars available for a qualified long term care event. If the client receives benefits to pay for qualified long term care expenses, those benefits would be tax-free.

- 6. What are the new tax free exchange rules?** Beginning in 2010, tax free exchanges will be permitted from a new or existing non-qualified annuity to pay premium on a tax qualified long term care insurance policy.

- 7. 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.

- 8. Must the client exchange the entire annuity to get this benefit?** No, partial exchanges may be permitted. In this case, gain and basis are transferred pro-rata.

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

## Pension Protection Act (PPA) of 2006 FAQs (continued)

**10. What are the Genworth Financial companies' restrictions?** Any non-qualified immediate or fixed deferred annuity, issued by the Genworth Financial companies, its subsidiaries or predecessors, is eligible for partial 1035 exchanges. However, contracts with restriction endorsements or irrevocable payees may not be eligible. The Genworth Financial companies' variable annuities may not be partially exchanged at this time. Full 1035 exchanges of Genworth Financial companies' non-qualified deferred annuities are acceptable after 1/1/2010, provided that no more than 2 years of premium are paid. Annuities issued by other companies may be eligible, subject to the issuing company's restrictions. You should contact the issuing company to verify eligibility. Surrender charges may apply and should always be considered.

**11. Do the 1035 rules apply to life insurance as well?** Yes, the new 1035 rules also allow you to exchange all or part of a life insurance policy for a traditional or Linked Benefit LTCI policy, but suitability must be carefully considered.

**12. What if a client wishes to fund traditional long term care insurance with a non-qualified Single Premium Immediate Annuity (SPIA)?** Key Change Effective 1/1/2010, your client can assign the SPIA in part to fund LTCI, such that SPIA payments are directed from the annuity issuer to the LTCI company to pay qualified long term care insurance premiums.

Using SPIA payments to fund long term care is a strategy used today. However, the portion of the premium that constitutes gain is taxable as ordinary income to the annuity owner.

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.

**13. What if my clients "self insure" and pay LTC costs from a non-qualified annuity?**

Partial withdrawals from a deferred annuity are generally taxable as ordinary income to the extent of gain in the contract. Annuitized payments are given an exclusion ratio – meaning that a portion of the payment may represent a tax free return of premium.

If they itemize on their federal income tax return, they may be able to take a deduction for their long term care costs as unreimbursed medical expenses.

**14. What are the advantages of using a Linked Benefit annuity to fund long term care expenses?** Effective 1/1/2010, the withdrawals to pay for qualified long term care expenses from these contracts will be tax free. The IRS is expected to issue guidance on the impact of such payments on the cost basis of the underlying annuity contract. Clients should consult their tax advisors concerning the tax treatment of their annuity contracts.

The long term care riders in these products typically provide a long term care benefit pool from 2 to 3 times the premium placed into the contract.

By utilizing IRC section 1035, a non-qualified annuity may be exchanged for a Linked Benefit annuity, and this would allow the gain in the contract to be received tax free for qualified long term care expenses.

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