Exchanging Annuities and Life Insurance for Long-term Care Insurance: 1035 Exchange FAQs

Q. What 1035 exchanges are permitted?

A. The following 1035 exchanges are permitted:

From	To	Type of Exchange
Life Insurance	EXISTING qualified Long-Term Care (LTC) Insurance	Full exchange only
	NEW qualified LTC Insurance	Full exchange only
	NEW Life Insurance with LTC	Full exchange only
Life Insurance with Long-Term Care	NEW Life Insurance with LTC	Full exchange only
Nonqualified Annuity	NEW qualified LTC Insurance	Partial or full exchange
	EXISTING qualified LTC Insurance	Partial or full exchange

Q. Will clients under the age of 59½ be assessed the 10% federal tax penalty on annuity distributions and distributions from life contracts that are considered Modified Endowment Contracts (MEC)?

A. IRC §1035 states no gain or loss shall be recognized for permitted exchanges. Therefore, the 10% federal tax penalty would not apply to an annuity or MEC to LTC exchange. It is unknown how/if the IRS will provide different treatment in the future.

Q. Is there any benefit in partially exchanging an annuity contract to pay the premium for LTC insurance?

A. By partially exchanging an annuity contract to pay for LTC insurance premiums, the owner might be able to avoid taxes on the gain portion of the amounts exchanged, which would otherwise be taxable when withdrawn.

Q. Must a client exchange the entire annuity contract?

A. No. Partial exchanges are permitted. In that case, gain and basis are transferred in a pro-rata fashion under current law. Section 3 of Notice 2003-51 provides an example of the pro-rata calculation. Thrivent will use a two decimal rounding convention when doing its calculation.

Thrivent Example	Calculation
$62,269.69 current cash value $60,000.00 current cost basis $5,467.50 partial 1035 exchange	$5,467.50/$62,261.69 = 0.08781 (rounds to 0.09) $60,000 x 0.09 = $5,400 $5,400 cost basis $67.50 gain
$343,267.17 current cash value $240,230.84 current cost basis $1,883.20 partial 1035 exchange	$1,883.20/$343,267.17 = 0.0054 (rounds to 0.01) $240,230.84 x 0.01 = $2,401.31 $1,883.20 cost basis $0.00 gain

Q. Must a client exchange the entire life insurance contract?

A. Yes, currently, life insurance is not eligible for tax-free partial 1035 exchange to LTC. Many life insurance contracts have too much cash value to be fully exchanged for a LTC insurance contract. One alternative may be to exchange the full life insurance contract for a deferred annuity and then do partial exchanges from the annuity to fund the LTC insurance contract.

Q. Are there restrictions for partial exchanges of Thrivent products?

A. Yes, only *deferred* annuities are eligible for **partial** 1035 exchanges. **Thrivent Immediate annuities are not eligible for partial or full 1035 exchanges due to contract language.** In addition, contracts with irrevocable beneficiaries or payees may not be eligible. Annuities issued by other companies may be eligible, subject to the issuing company's own restrictions. The issuing company should be contacted to verify eligibility.

Q. A client has a variable annuity or variable universal life contract with no gain. Would there still be a benefit associated with the 1035 exchange?

A. There is unlikely to be any benefit in exchanging a variable contract with no gain for a LTC insurance contract.

Q. Does it matter if a Thrivent deferred annuity has been annuitized?

A. Thrivent settlement options are not eligible for 1035 exchange.

Q. If a client has recently received an annuity or life insurance contract withdrawal, can they make a 1035 exchange by submitting a check (or endorsing the un-deposited withdrawal check) to pay the LTC insurance premium?

A. No. The transfer of funds can't pass through the contract owner's hands or financial accounts. It must occur between or within insurance companies.

Q. Can the owners of an existing jointly owned annuity pay for a LTC contract owned by one of the joint annuity owners via 1035 exchange?

A. No, the ownership of the annuity contract and LTC contract must be the same. In addition, the IRS has not provided guidance whether the annuitant must match the insured on the LTC contract. If the owner(s) match and the annuitant(s) do not match the insured(s) on the LTC contract, Thrivent will require the 1035 Annuity to Pay Long Term Care Disclosure form (29713) to be submitted.

Q. Can the sole owner of an existing annuity pay for a jointly owned LTC contract via 1035 exchange?

A. No, the owner(s) of the annuity contract must be the same as the contract owner(s) of the LTC contract. In addition, the IRS has not provided guidance whether the annuitant must match the insured on the LTC contract. If the owner(s) match and the annuitant(s) do not match the insured(s) on the LTC contract, Thrivent will require the 1035 Annuity to Pay Long Term Care Disclosure form (29713) to be submitted.

Q. Can the sole owner of an existing life insurance contract pay for a jointly owned LTC contract via 1035 exchange?

A. No, for the life insurance contracts the insured(s) and contract owner(s) must be the same as the insured(s) and contract owner(s) of the LTC contract.

Q. Can a 1035 exchange be done from a trust-owned annuity to pay for an individually owned LTC contract?

A. Yes, if the trust qualifies as a "grantor trust" under IRS rules and the LTC contract is owned by the grantor. A grantor trust is one that generally uses the grantor's SSN and is revocable by the grantor. Thrivent will rely on representations made on the Certification of Trust to make this determination.

Q. Will surrender or decrease charges be incurred during a 1035 exchange?

A. Deferred annuities or life insurance contracts may assess surrender or decrease charges. If the annuity is within its surrender charge period and the amount transferred to fund a LTC 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.

Q. Can non-qualified SPIA payments funding a LTC insurance contract qualify for 1035 tax treatment?

A. Generally, yes, if the SPIA is directly funding the LTC insurance contract pursuant to an assignment. Thrivent's immediate annuities cannot be 1035 exchanged due to contract language.

Q. What paperwork is needed to request a 1035 exchange?

A. The paperwork varies, for:

- Exchanges to Thrivent LTC insurance contracts, including the contracts administered by Long Term Care Group (LTCG) see the 1035 Exchange Overview on FieldNet.
- LTC insurance issued by other companies may be eligible, subject to the issuing company's own restrictions. The issuing company should be contacted to verify eligibility and to obtain paperwork.

Q. When will the 1035 exchange be requested?

A. The process for requesting the 1035 may vary:

- 1035 exchange proceeds will be requested when the paperwork is in good order for exchange to pay premiums on Thrivent LTC insurance contracts.
- The issuing company should be contacted regarding their procedures for LTC insurance contracts issued by other companies.

Q. Will Thrivent accept a request for recurring 1035 exchanges to pay the annual premium on a LTC insurance contract?

A. Yes, if the funding contract is a Thrivent annuity.

- For Thrivent annuity contracts, request the recurring 1035 exchange using Assignment and Agreement for 1035 exchange form (8906).
- Form 8906 for recurring 1035 exchange from a Thrivent annuity contract may be sent in at any time. If the form is received in good order before the receiving LTC contract can accept the funds, the first annuity distribution will be processed and effective the date the receiving contract can accept the funds.
- For detailed questions or to stop the recurring 1035 exchange payments, call the Annuity Interaction Center at 888-422-5737 and say “annuities.”