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No Longer Need that Old Life Insurance Policy? Reposition It for Income Now … or Later

- **Do you have an old cash-value life insurance policy that has served its purpose?**
- **Would a protected retirement income stream – one you cannot outlive, regardless of market conditions – now better address your needs?**
- **Do you know you can exchange that old policy – generally tax free – for an immediate or deferred annuity?**

Consider Your Options

Of course, you can always surrender the old policy. But, if there's any gain in the policy, you'll need to include that amount in your gross income on your tax return. There it will be taxed as ordinary income. Gain is generally determined by subtracting the total premiums you've paid (your cost basis) from the policy's current cash value.

Even if there's no gain in the policy, there may still be a good reason not to surrender it. If you've paid more into the policy than its current cash value, you'd be walking away with a loss that you can't claim on your tax return.

Exchanging a policy that's "underwater" (i.e., its cash value is less than the total premiums paid for it) for a nonqualified (NQ) annuity can:

- preserve the cost basis and thereby
- allow it to be recovered tax free from the annuity payouts

A life insurance policy might be underwater for a variety of reasons. One reason might be lower-than-expected interest rates on whole life or universal life policies. Another reason might be lower-than-expected subaccount values in variable life policies.

1035 Exchange: Section 1035 of the Internal Revenue Code allows for certain tax-free exchanges of life insurance and annuity contracts. For example, a life insurance policy can be exchanged for either another life insurance policy or for an annuity.

Life Insurance to Annuity Exchange

Exchanging a life insurance policy for a NQ annuity is a permitted nontaxable exchange, provided the:

- Owner of both contracts is the same, and
- Annuitant on the new annuity contract is the same as the insured on the old life insurance policy

Issuers: Integrity Life Insurance Company | National Integrity Life Insurance Company | Western-Southern Life Assurance Company

For Example: Joan Jumps from Life Insurance to Annuity

Joan, age 55, owns a permanent life insurance policy. It's underperformed her expectations. She's considered her reasons for ownership carefully and decided she no longer needs it. Her situation:

- She's paid total premiums of $160,000 ($16,000 annually for 10 years). That's the policy's cost basis. But the policy's cash value is only $115,000.
- If she surrenders the policy, Joan receives no tax benefit from having paid more for the policy than it was worth at the time of surrender.
- If Joan executes a 1035 exchange of the $115,000 cash value into a NQ annuity, her cost basis of $160,000 can be recovered tax-free from the annuity payout.

If Joan desires **income now**, she could exchange the life policy for a single premium immediate annuity (SPIA). She would buy the SPIA with a $115,000 premium (the life policy's cash value) and the SPIA would have a $160,000 cost basis. She would have an exclusion ratio of 100% and, provided she lives that long, would receive her payments tax-free for nearly 32 years (31.6 to be exact, representing her remaining life expectancy[1]). Payments received *after* that point will be fully includible in her taxable income. In year 23 Joan would recover the total premium paid.

If Joan prefers **income later**, she could exchange the life insurance policy for a deferred annuity.

Finally, Joan can also add additional funds from her savings. By doing so, she'll increase the monthly amount of protected lifetime income she'll receive from the immediate or deferred annuity. Any additional premium would also be recovered tax-free from the annuity payouts.

Exclusion Ratio: The portion of a nonqualified annuity's return that is not taxed. It's a percentage of the total payout equal to the amount of money originally invested. Payback of the purchase premium is free of tax.

Ready to discuss specifics of what exchanging life insurance protection for retirement income may mean for you? Contact your financial professional.

1 Source: IRS Table 1 - Single Life Expectancy, Appendix B, Publication 590-B