1035 Exchanges for Life Insurance

PRODUCER GUIDE

WHAT IS A 1035 EXCHANGE?

Section 1035 of the Internal Revenue Code (IRC) allows the **tax-free transfer** of existing contracts, including life insurance policies and annuity contracts, for another of like kind. The taxpayer's cost basis in the original contract is transferred to the new contract.

For a transaction to qualify as a 1035 Exchange, the "old" contract must actually be exchanged for a "new" contract as one continuous transaction. It is not sufficient for the policyholder to receive a check and apply the proceeds to the purchase of a new contract. The exchange must take place between the two insurance companies.

Follow the tips in this guide for the smoothest and most efficient processing of your 1035 Exchange application.

Which exchanges are eligible under Section 1035?

- A life insurance contract exchanged for another life insurance, endowment or annuity contract
- An endowment contract exchanged for an annuity contract or for another endowment contract that provides for regular payments to begin no later than they would have begun under the old contract, or
- An annuity contract exchanged for another annuity contract.

Note: The information in this guide only applies to the 1035 Exchange process for AIG's Life Insurance business. There are separate requirements and forms for AIG's Annuity business.

What's not eligible for a 1035 exchange?

- Spouse A exchanges a policy insuring only his life for a policy which insures the lives of both Spouse A and Spouse B.
- Spouse A exchanges two life insurance policies, one of which insures Spouse A and the other of which insures Spouse B for a policy insuring the lives of both Spouse A and Spouse B.
- Spouse A and Spouse B jointly exchange separate policies, each of which insures the life of one spouse for a single, jointly-owned policy which insures the lives of both Spouse A and Spouse B.

WHERE TO SUBMIT

- **Application Part A**
- **Absolute Assignment Form**
- **Original Paperwork/Contract**
- **1035 Exchange Checks From Exchanging Carrier**

Submit these items to:

American General Life
2727A Allen Pkwy, Mail Stop 6H1 (1035)
Houston, TX 77019

Use this address for both regular and overnight mail.

- **Unsigned Illustration or Quote**
- **Delivery Requirements**
- **Initial Premium Checks**

Send these items to your usual address or lockbox for New Business applications.

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REQUESTING A 1035 EXCHANGE

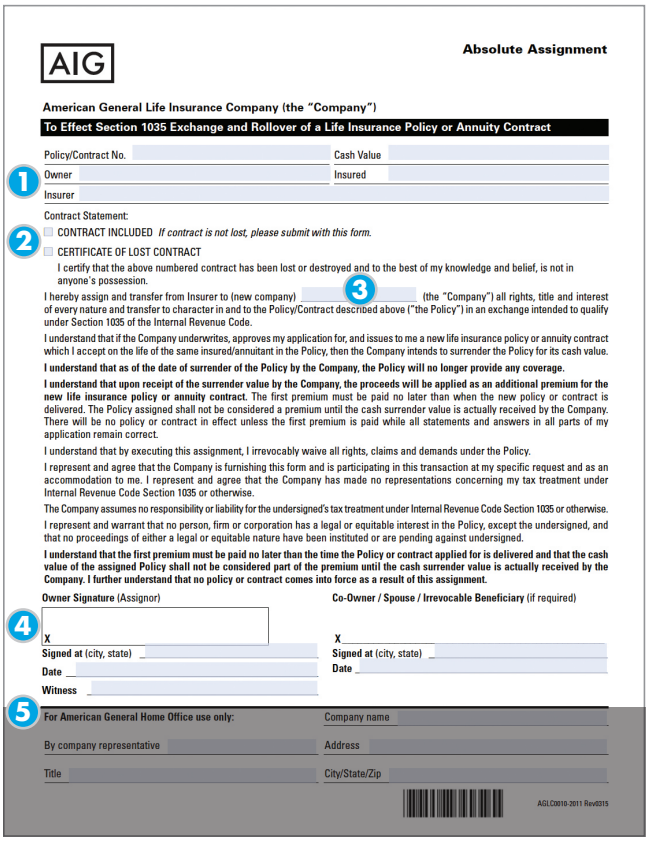
To request a 1035 Exchange for a new life insurance policy, fill out the **Absolute Assignment Form** and submit it with your **Application Part A**. You can find the form on Forms Depot, or click the link below.

- **American General Life version - AGLC0010-2011** Use in all states except New York.
- **US Life version - 00850001-1021** Use in New York State only.

See the Where to Submit section above for mailing address.

TIPS FOR COMPLETING THE ABSOLUTE ASSIGNMENT FORM

Please ensure all fillable sections are completed on the form. Please note the following:



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Absolute Assignment

American General Life Insurance Company (the "Company")

To Effect Section 1035 Exchange and Rollover of a Life Insurance Policy or Annuity Contract

Policy/Contract No. | Cash Value

1 Owner | Insured

Insurer

Contract Statement:

2 ☐ CONTRACT INCLUDED *If contract is not lost, please submit with this form.*

☐ CERTIFICATE OF LOST CONTRACT

I certify that the above numbered contract has been lost or destroyed and to the best of my knowledge and belief, is not in anyone's possession.

I hereby assign and transfer from Insurer to (new company) 3 (the "Company") all rights, title and interest of every nature and transfer to character in and to the Policy/Contract described above ("the Policy") in an exchange intended to qualify under Section 1035 of the Internal Revenue Code.

I understand that if the Company underwrites, approves my application for, and issues to me a new life insurance policy or annuity contract which I accept on the life of the same insured/annuitant in the Policy, then the Company intends to surrender the Policy for its cash value.

I understand that as of the date of surrender of the Policy by the Company, the Policy will no longer provide any coverage.

I understand that upon receipt of the surrender value by the Company, the proceeds will be applied as an additional premium for the new life insurance policy or annuity contract. The first premium must be paid no later than when the new policy or contract is delivered. The Policy assigned shall not be considered a premium until the cash surrender value is actually received by the Company. There will be no policy or contract in effect unless the first premium is paid while all statements and answers in all parts of my application remain correct.

I understand that by executing this assignment, I irrevocably waive all rights, claims and demands under the Policy.

I represent and agree that the Company is furnishing this form and is participating in this transaction at my specific request and as an accommodation to me. I represent and agree that the Company has made no representations concerning my tax treatment under Internal Revenue Code Section 1035 or otherwise.

The Company assumes no responsibility or liability for the undersigned's tax treatment under Internal Revenue Code Section 1035 or otherwise.

I represent and warrant that no person, firm or corporation has a legal or equitable interest in the Policy, except the undersigned, and that no proceedings of either a legal or equitable nature have been instituted or are pending against undersigned.

I understand that the first premium must be paid no later than the time the Policy or contract applied for is delivered and that the cash value of the assigned Policy shall not be considered part of the premium until the cash surrender value is actually received by the Company. I further understand that no policy or contract comes into force as a result of this assignment.

Owner Signature (Assignor) | **Co-Owner / Spouse / Irrevocable Beneficiary** (if required)

4 X | X

Signed at (city, state) | **Signed at** (city, state)

Date | **Date**

Witness

5 **For American General Home Office use only:** | Company name

By company representative | Address

Title | City/State/Zip

AGLC0010-2011 Rev0315

1 Ownership

- The owner(s) must be the same for the existing policy and for the replacement policy.
- If a trust owns, include the trust's full name, established date, and trustee's name and title in the Owner section.
- To reduce possible processing delays, please contact the existing carrier before completing the Absolute Assignment form to ensure the Insured/Owner information in their system exactly matches the information provided in the form, including middle names, initials, Jr./Sr., etc.

2 Contract section

- Select one of the two contract options provided: **Contract Included** or **Certificate of Lost Contract**.

3 Provide the correct Company name in the blank space as indicated:

- "American General Life" for all states except New York.
- "US Life" only for New York applications.

4 Signature options

- Only wet signatures accepted for external 1035 exchanges.
- Wet and electronic signatures accepted for internal exchanges.

5 Home Office Use Section

Leave this section blank; it will be completed by the home office.

Keep in Mind

- If the existing policy is assigned, it must be released before the exchange is completed or it must carry over to the new policy. The Absolute Assignment Form will need the assignee signature.
- If the client lives in a Community Property state and is married, the spouse must sign as the co-owner. Community Property states are **Arizona**, **California**, **Louisiana**, **Nevada**, **New Mexico**, **Texas**, **Washington** and **Wisconsin**. **Alaska** is an opt-in community property state that gives both parties the option to make their property community property.

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WHAT HAPPENS AFTER THE APPLICATION

Our New Business and Case Relationship Management teams will stay in touch and guide you through any requirements or additional needs. Here's what to expect after submitting your application.

IF APPROVED AS APPLIED

- If the new policy is approved as applied for (or better than applied) and no amendments are needed, we will immediately write out for the 1035 funds.
- If the 1035 proceeds differ from the original illustration, you will be advised to submit a revised (unsigned) illustration reflecting the amount of the 1035 proceeds received.
- Upon receipt of the illustration, we will conditionally issue the policy and await the signed illustration, premium, and any other delivery requirements needed to put the case in force.

IF APPROVED OTHER THAN APPLIED

- If the new policy is approved other than applied (or approved as applied but with additional amendments), a 1035 Application Amendment will be posted to the Correspondence section of our producer website. The amendment will reflect:
  - The approved rate class
  - Additional items that need to be amended
  - A statement authorizing us to proceed with the 1035 exchange
- Upon receipt of the signed 1035 Application Amendment, we will write out for the funds.
- Once we receive the 1035 proceeds, you will be notified of the amount received and advised that a new illustration will be needed to reflect the exact amount of the 1035 proceeds.
- Once the unsigned illustration is received, the case will be conditionally issued.
- The case will be placed inforce upon receipt of the signed illustration, premium due (if any) and any other forms needed on delivery.

KEEP IN MIND

Some carriers require current-dated Absolute Assignment forms in order to proceed with an exchange. We may request a new form if the exchanging carrier refuses to accept the form we have on file without a current date.

Coverage begins when we write out for the 1035 funds, as long as the exchange amount is adequate to pay the first premium and all other outstanding requirements for the new policy are met.

We will accept premium at any point in the exchange process. If the policy owner prefers that we put the policy in force simultaneously with the 1035 write-out, please contact your Case Relationship Manager for instructions on what is needed.

Only wet signatures **are accepted for external 1035 exchanges.**
Wet and electronic signatures **are accepted for internal exchanges.**

INTERNAL 1035 EXCHANGES

What's Eligible for an Internal Exchange?

The following replacement scenarios are eligible for an internal exchange:

- Replacement of a Universal Life policy with a new Universal Life product.
- Replacement of a Variable Universal Life (VUL) policy with a new Universal Life product.
- Replacement of a Universal Life policy with a new VUL product.

The following products or scenarios are not eligible for an internal exchange:

- Whole Life policies
- Exchanging a VUL policy to another Variable Life policy
- Annuity policies

Transfer Values and Surrender Charges

For internal 1035 exchanges involving AGL, USL or internal affiliates, the following is used to determine the value being transferred from the original policy to the new policy.

- If there is no surrender charge on the existing policy, the full accumulation value is transferred.
- If the 1st year surrender charge on the new policy is higher than the charge on the existing policy, the charge is waived and the full accumulation value is transferred.
- If the 1st year surrender charge on the new policy is lower than charge on the existing policy, the difference between the two is used as the surrender charge for the 1035 process.

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Questions?
Reach out to your Producer Contact Center.

Policies issued by American General Life Insurance Company (AGL), Houston, TX, except in New York, where issued by The United States Life Insurance Company in the City of New York (US Life). Issuing companies AGL and US Life are responsible for financial obligations of insurance products and are members of American International Group, Inc. (AIG). AGL does not solicit business in the state of New York. Products may not be available in all states and product features may vary by state.

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1035 Exchange UPDATE

1035 Frequently Asked Questions

What is a 1035 Exchange?

Section 1035 of the Internal Revenue Code provides a method for exchanging various insurance contracts for other insurance contracts while deferring the recognition of income that may otherwise result if the existing contract is surrendered and replaced later with another contract. The taxpayer's cost basis in the original contract is transferred to the new contract. If the original policy was a Modified Endowment Contract, the new policy will also be a Modified Endowment Contract.

For a transaction to qualify as a 1035 Exchange, the "old" contract must actually be exchanged for a "new" contract as one continuous transaction. It is not sufficient for the policyholder to receive a check and apply the proceeds to the purchase of a new contract. The exchange must take place between the two insurance companies.

What other names are used when referring to a 1035 Exchange?

- Section 1035 of the Internal Revenue Code
- Tax-Free Exchange
- IRC Section 1035

What exchanges may be made without income taxation?

A tax-free section 1035 exchange is the exchange of:

- A life insurance contract for another life insurance, endowment or annuity contract
- An endowment contract for an annuity contract of for another endowment contract that provides for regular payments to begin no later than they would have begun under the old contract, or
- An annuity contract for another annuity contract.

What exchanges cannot be made on a tax-free basis under I.R.C. section 1035?

- Spouse A exchanges a policy insuring only his life for a policy which insures the lives of both Spouse A and Spouse B.
- Spouse A exchanges two life insurance policies, one of which insures Spouse A and the other of which insures Spouse B for a policy insuring the lives of both Spouse A and Spouse B.
- Spouse A and Spouse B jointly exchange separate policies each of which insures the life of one spouse for a single, jointly-owned policy which insures the lives of both Spouse A and Spouse B.

American General Life Companies, www.americangeneral.com, is the marketing name for the a group of affiliated domestic life insurers, including American General Life Insurance Company and The United States Life Insurance Company in the City of New York.
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THE UNITED STATES LIFE Insurance Company
A USLIFE COMPANY

What you should know about Exchanges of Insurance Policies under Section 1035 of the Internal Revenue Code*

Q. What are the tax consequences of surrendering a life, endowment or annuity policy?

A. Generally, when an existing life insurance, endowment or annuity policy is fully surrendered and the surrender proceeds are received by the policyholder in a single sum, such proceeds are taxable as ordinary income to the extent that they exceed the cost of the policy. However, for life and endowment policies, if the policy cost exceeds the lump sum payment, there is not a deductible loss.

Q. How are policy costs calculated?

A. The policy's cost is normally considered to be the aggregate total of premiums paid, less the cost of other benefits (i.e., waiver of premium, term riders, etc.) less dividends previously paid.

Q. What are the tax advantages of a 1035 exchange?

A. If a person exchanges certain enumerated insurance policies under IRC Section 1035 then:

1. no gain or loss is recognized on the exchange, and
2. the adjusted tax basis of the old contract is carried over to the new contract.

Q. What insurance contracts qualify for a 1035 exchange?

A.

1. A life contract may be exchanged for another life contract, an endowment contract, or an annuity contract.
2. An endowment contract may be exchanged for another endowment contract with the same maturity date of the original contract exchanged or an annuity contract.
3. An annuity contract may be exchanged for another annuity contract only.

Q. What requirements must be met for an exchange to qualify under Section 1035 of the IRS code?

A.

1. The exchange must involve the kinds of insurance policies described in the statute, in the order described.
2. The insured or annuitant must be the same under both policies.
3. The owner must be the same under both policies.
4. The transfer must be made directly from one insurance company to another.
5. The insured or annuitant may not take possession of the cash value and subsequently transfer it to the new insurance company.
6. A proper exchange utilizing the proper forms and procedures must occur.

Q. Are state replacement forms required to be completed on 1035 exchanges?

A. Yes. Even though the existing policies are assigned to The United States Life Insurance Company, surrender is a foregone conclusion and state replacement laws should be strictly adhered to.

Q. What are the tax consequences of the 1035 exchange if part of the cash value is received in cash? Can a partial tax-free exchange occur?

A. On partial exchanges, only the actual gain transferred to the new contract in excess of the cash payment received can be recognized. However, no loss is recognized on partial exchanges.

Q. At what time must the completion of 1035/assignment papers take place?

A. In order to qualify as an exchange, the application for the new policy and the assignment of the existing policy must be contemporaneous.

Q. What are the tax consequences of a 1035 exchange if there is a loan on the existing policy?

A. To the extent that the loan amount on the original policy at the point of surrender exceeds the loan on the new policy at point of issue, the difference is considered to be a cash payment to the policyholder. Depending on the basis of the original contract this will either result in a reportable gain or reduce the basis in the new policy.

Q. Can multiple life policies (first/second-to-die) be used in connection with an exchange?

A. A recent private letter ruling issued by the IRS indicates disqualification from 1035 status in several instances including the exchange of two separate policies covering two individuals to a second-to-die covering the same two insureds as well as a scenario involving exchange of a policy on one insured to a second-to-die policy covering that individual and his spouse.

In those situations where the facts establish that the replacement of an existing insurance policy by a United States Life contract is warranted, a Section 1035 Exchange can provide additional advantages to your client. However, the IRS Code 1035 must be complied with if the desired result is to be achieved.

*The suggestions contained herein are for information purposes only and must not be construed as the giving of legal or tax advice. With respect to any statutory questions, your clients should be referred to their attorney and/or tax adviser, for proper counseling.

1035 Exchanges of Life Policies

Many of the calls we receive consist of questions about 1035 exchanges. With that in mind, here are a few things readers should watch out for.

Section 1035 of the Internal Revenue Code allows a taxpayer to exchange old life policies and annuities for new ones without paying tax on the gain. An individual may replace a life insurance policy with another life policy or an annuity. An annuity may be replaced with another annuity. A person cannot exchange tax-free an annuity to a life insurance contract.

Exchange of Life Policy With Loan

There are policy transfers which may not qualify as tax-free exchanges. One such transfer is the exchange of a life policy with an outstanding loan. Money or other property received as part of an exchange is known as "boot." If a policy, in which the owner has a gain, is exchanged for a new one and the loan on the old policy is paid off, the owner has taxable boot. The boot is the lesser of the loan repaid or the gain in the policy.

In several rulings the IRS has held a policy may be exchanged tax-free for another policy subject to the same amount of indebtedness. If the new insurance company will not issue a policy with a loan against it the taxpayer has two options: (1) pay off the loan on the old policy with funds from another source and then borrow on the new policy, if necessary; or (2) exchange the policy, "bite the bullet" and pay the tax generated when the loan on the old policy is extinguished.

Another Technique, Still Taxable Boot

The IRS may find taxable boot in a step transaction. In Private Letter Ruling 9141025, a taxpayer owned a life insurance policy bought with a single premium of $1 million; there was a $448,000 outstanding loan on the policy. The taxpayer proposed to pay off the loan through a partial surrender (withdrawal) from the policy.

The taxpayer expected to treat the withdrawal as a tax-free return of premium. The plan was to then exchange the remaining cash value for a new policy and treat it as a 1035 exchange.

Smartly, the taxpayer asked the question before doing the act. IRS held the proposed transaction would cause taxable boot equal to the extinguished $448,000 loan; the policy withdrawal would not be an independent transaction but part of a step transaction.

The Three-Year Rule

When an insured gives away a policy on his or her life and dies within three years, the death proceeds are fully included in the insured's estate.

Individuals often establish irrevocable trusts to own life insurance outside of their estates. Many of our callers mistakenly believe if an existing policy is exchanged for a new one owned by an irrevocable trust, the three-year rule does not apply. This is incorrect. If the new policy owned by a trust is the result of a conversion or exchange of an existing policy given to the trust, the policy is treated as if the insured had owned it if death occurs within three years.

Single For Joint, Joint For Single

In exchanges of life insurance policies, the insureds on both the old and new policies must be identical. In Private Letter Ruling 9542037, the Service ruled the exchange of a single life policy on the husband for a joint life policy on husband and wife was not tax-free because the insureds weren't identical. Similarly, the exchange of two policies – one on the husband and one on the wife – for a new joint policy on husband and wife didn't qualify as a 1035 exchange. The converse also holds true; a joint life policy on husband and wife cannot be exchanged tax-free for two individual policies, one on husband, one on wife. However, the Service did rule in Private Letter Ruling 9330040, that it's possible to do an exchange of a joint policy after the death of one of the insureds for a single life policy on the survivor.