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The Benefits of a 1035 Exchange

A **1035 Exchange** is the replacement of one insurance policy (or annuity, for example) with another policy. Because there are no tax consequences, this can be a substantial benefit. The term '1035 Exchange' refers to Section 1035 of the Internal Revenue Code.

Resources

Learn more:
www.investopedia.com
www.finra.org

Benefits At-a-Glance

- Upgrade policy features
- Tax-Free transfer of assets
- Not necessary to 'surrender' asset
- Life insurance to annuity exchanges
- Endowments to annuity exchanges
- Consolidate multiple policies

Replacing one insurance policy for another offers an investor the opportunity to exchange an expensive or outdated insurance contract for a different contract offering better features. For example: a policy owner might choose a contract with lower costs, different investment options or they may seek a higher death benefit.[1]

There are also tax advantages to a 1035 Exchange. When "Surrendering" or cashing out an insurance policy invested with non-qualified[2] money, any investment gains are taxed as ordinary income.

However, a 1035 Exchange allows the non-taxable transfer of an old contract to a new contract, if IRS stipulations are met. The transaction must also be a direct exchange carried out between insurance companies.

Note that a 1035 Exchange applies only under certain conditions. Both the old and new contracts must be held by the same policy owner, with the same insured.

Only certain types of contracts can be exchanged: annuity contracts, life insurance policies, long-term care products and endowments.

An old endowment contract can be exchanged for an annuity and an annuity can be exchanged for another annuity. A life insurance policy can be exchanged for another life insurance policy or an annuity.

Contract holders may exchange two or more old contracts for one new contract, if the contracts belong to the same owner and insured. Investors may also choose a Partial 1035 Exchange involving only a portion of the original contract's amount, although any gain is subject to ordinary income taxes when withdrawn, and some insurance companies may not recognize partial 1035 Exchanges for tax reporting purposes.

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1 Consult with your investment advisor before replacing one policy with another. Before switching, consider any surrender charges or expenses that may be incurred, and any features that may not be available in the new policy.

2 Qualified money is money that is invested, typically in employer plans, before taxes are withdrawn. Nonqualified investements are those upon which the investor pays taxes before the money is invested.

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