Genworth Financial

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CASE SPOTLIGHT

GNWAM08-13
March 28, 2008

Preserving a Life Insurance Policy Tax Loss

CUSTOMER PROFILE

69-year-old female needs income for life

Wants to use life insurance policy cash value to supplement retirement income

Life insurance policy's basis is $100,000, but its cash value is only $3,000

PRODUCT

SecureLiving℠ Income Provider Single Premium Immediate Annuity (SPIA)

THE CHALLENGE

The client owned a life insurance policy into which she had paid $100,000 in premiums, but which was worth only $3,000 (with no policy loans). It was within two months of lapsing, and she no longer needed the coverage. She wanted to surrender the policy and use another $100,000 she had in the bank to buy a SPIA. She reasoned that there was no need to do an Internal Revenue Code (IRC) §1035 exchange because the policy had no gain to preserve.

The $100,000 SPIA with installment refund she was planning to buy would pay $635 per month for life. $208 of each payment would be taxed as ordinary income until she reached life expectancy. Thereafter, the entire payment would be taxed. At her combined 36% federal and state income tax bracket, she would net $560 per month.

Could she get a better result? Yes, she could.

HOW WE PLACED THE BUSINESS

We suggested an exchange instead of a surrender. By exchanging her life insurance policy into the SPIA and adding the $100,000 from the bank, the purchase payment would grow by $3,000 and annuity payments, by $19 per month to $654. More importantly, though, the annuity cost basis would increase to $200,000, and the exclusion ratio would rise to 100%. The client would get each annuity payment income tax-free (until basis was fully returned in almost 25½ years).

RESULT

It's unfortunate that the client's life insurance policy performed so poorly. But not making the most of the policy's losses would have been worse. By structuring this transaction as an exchange instead of a surrender, the client increased her after-tax income by $94 each month. Over the course of the SPIA's more than 13-year installment refund period that amounts to almost $15,000 more than she (or her beneficiary) would have otherwise had.

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