INSURANCE 101

BENEFITS THAT PASS THE TEST

GUIDELINE PREMIUM & CASH VALUE ACCUMULATION

Protecting loved ones is the main purpose of permanent life insurance, but it has some important tax benefits too. These include:

- Income tax-free death benefits
- Tax-deferred cash value accumulation
- Tax-free loans and withdrawals*

Because of these tax advantages, life insurance is subject to certain "tests" to ensure that the product meets Internal Revenue Code requirements to qualify as a life insurance contract and maintain its tax-favorable status.

The Guideline Premium Test (GPT) and the Cash Value Accumulation Test (CVAT) are the two tests that determine if a policy qualifies as life insurance. A life insurance company may permit you to choose the test to which the policy will comply, though that is not always the case. Once issued, the test cannot be changed. The choice of test will impact the policy premiums, cash value, expenses, and benefits.

HOW DOES GPT WORK?

The GPT limits the premiums that may be paid for a contract and limits the relationship between the cash value and the death benefit. A contract satisfies the guideline premium requirements if the sum of the premiums paid under the contract does not at any time exceed the guideline premium limitation.

The Guideline Single Premium (GSP) is the premium necessary at the date of issue to fund future benefits under the contract. The Guideline Level Premium (GLP) is the level amount payable over a period that does not end before the insured attains age 95 or after age 100, which is necessary to fund the future benefits under the contract. The guideline premium limitation equals the greater of the guideline single premium or the sum of the GLPs at that time.

The GLP is the **maximum** that can be paid into the policy **annually** over the life of the contract without violating the GPT. The GLP limit is cumulative, meaning if the policy owner chooses not to place the entire GLP into the contract in one year, that deficit can be added to the policy in a subsequent year, subject to the cumulative GLP limit for that year (or the GSP limit if greater).

With an increasing death benefit option, the GLP is higher. This is because the GLP is calculated based on the premiums that would fund the future benefits in the contract. Since the increasing death benefit option includes the cash accumulation value, future benefits may be higher.

*** Loans, withdrawals, and death benefit accelerations will reduce the policy value and the death benefit and may increase lapse risk. Policy loans are tax-free provided the policy remains in force. If the policy is surrendered or lapses, the amount of the policy loan will be considered a distribution from the policy and will be taxable to the extent that such loan plus other distributions at that time exceed the policy basis.**

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The following is an example of the difference in the guideline annual premiums for a level versus increasing death benefit:

Male, Age 35 Preferred Elite $200,000 Face Amount	GLP	GSP
Level Death Benefit Option	$3,071.00	$45,309.00
Increasing Death Benefit Option	$8,990.00	$45,309.00

* *Example using Transamerica Financial Foundation IUL® II*

With GPT, the death benefit will automatically increase, when necessary, to maintain the required margin between the cash value and the death benefit. Cost of insurance charges will also increase due to the increased death benefit. This relationship between cash value and death benefit is often referred to as the "corridor." The corridor increase in death benefit is not necessarily permanent. The increase may be eliminated if the margin between policy death benefit and cash value is sufficient. The amount of GPT corridor is provided in the Internal Revenue Code. This will also result in an increase in cost of insurance due to the increased death benefit.

When should I use/suggest GPT for the client?

GPT is typically used when a client is more interested in lifetime cash accumulation with maximum policy distributions rather than maximizing the death benefit.

Please note: The GPT does not prohibit a policy from becoming a Modified Endowment Contract (MEC). This is especially important when considering maximum distributions.

HOW DOES CVAT WORK?

The CVAT also requires a certain margin be maintained between the death benefit and the accumulation value for all years. With CVAT, the cash value of the insurance policy cannot exceed the Net Single Premium required to fund future benefits. The CVAT imposes no limit on the amount of premium that can be paid.

When would I use CVAT for the client?

CVAT generally permits larger premiums to be contributed into a policy quicker with a lower initial death benefit than would be available with the GPT, thus producing a higher cash surrender value. CVAT is often used with large 1035 exchanges or single premium payments. Because of the large premium deposits allowed, the policy may create a MEC — which can have significant negative tax consequences if cash is taken out of or borrowed against the policy. However, at ages closer to the insured's life expectancy, a policy that uses CVAT may require a higher death benefit and may rise more quickly then would GPT. Therefore, for a client who seeks to maximize the death benefit without the need to take cash out of the policy, CVAT might be a good option. Keep in mind a higher death benefit will result in higher cost of insurance charges.

Note: *Transamerica Illustrations will not allow a disqualification of the GPT or the CVAT. Death benefits and/or premiums will be automatically adjusted to ensure compliance If a policy fails the GPT or the CVAT, the policyholder will be contacted to determine next steps..*

The company and its agents do not give tax or legal advice. This material and the concepts presented here are for informational purposes only and should not be construed as tax or legal advice. Any tax and or legal advice that you may require or rely on regarding this material should be based on the particular circumstances and should be obtained from an independent professional. To ensure compliance with federal tax law, Transamerica will monitor the level of death benefit and premiums, and reserves the right to adjust the death benefit and limit or refund any amount of premium, to preserve the qualification of the policy as a life insurance contract. As provided in the policy, Transamerica will automatically adjust the death benefit to maintain the minimum margin. Increasing the death benefit increase may increase the cost of insurance charges for the policy. Changes or transactions that reduce benefits may require a distribution of cash from the policy to you in order to maintain the status of the policy as a life insurance contract. If the policy is not a modified endowment contract, some or all of a distribution that is required due to a benefit reduction in the first fifteen years may be taxable as ordinary income, while such distributions in later years will be nontaxable to the extent of basis in the policy. If the policy is a MEC, a distribution in any year will be taxable as ordinary income to the extent of gain in the contract.

Under Guideline Premium Test, distributions required as a result of a requested change or transaction may be required in the year of the change and in future years thereafter.

Please refer to Section 7702 of the Internal Revenue Code for details.