

MAKING THE MOST OF IT

UNDERSTANDING 1035 EXCHANGES

DEFINITION OF 1035 EXCHANGE:

Named after Section 1035 of the Internal Revenue Code, a 1035 exchange allows a life insurance or annuity contract to be exchanged on a tax-free basis, potentially without a current taxable event. Provided the rules are followed, this type of exchange allows your clients to replace a life insurance or annuity contract. These transferred funds are considered the policy's net cash value, which is the cash value less any outstanding loan balance or surrender penalties that may be present.

DEFINITION OF COST BASIS:

The original value or purchase price of a life insurance product, or other investment, for tax purposes. Cost basis is considered when determining the amount of a gain or loss that may be taxable. Clients should consult their own tax professionals to understand how the transaction will impact them.

ELIGIBLE PRODUCTS

Q. Which Transamerica life insurance product(s) accept 1035 exchange funds?
A. *Transamerica Financial Foundation IUL*® (FFIUL) and *Transamerica Financial Choice IUL*℠ (FCIUL)

Q. Will Transamerica be adding additional products that accept 1035 funds?
A. Our product team is working diligently to create new offerings. Once an additional product becomes available, agents will be notified.

Q. Which life insurance compliance test — Guideline Premium Test (GPT) or Cash Value Accumulation Test (CVAT) — is best when a 1035 exchange will be involved?
A. This is dependent on client situation/need. Speak with your Transamerica Distribution Support partner at the Sales Desk if you need assistance making that decision.

Both GPT and CVAT define the relationship between cash value and death benefit as life insurance, per policy requirements.

- With GPT, the 1035 exchange funds will count toward the premium paid under the Deficit Reduction Act (DEFRA) guidelines.
- With CVAT, the 1035 exchange funds do not count toward premiums paid under the 7-pay test. Because of this, clients may decide to use CVAT if they have a large 1035 exchange amount (in relationship to the face value) and want to minimize the initial death benefit.

Q. If my client's policy is set up at another carrier as a Guideline Premium Test or Cash Value Accumulation Test, does it have to be set up the same at Transamerica to be able to do a 1035 exchange?
A. No.

Q. What are the four key requirements to qualify for a 1035 exchange?
A. 1. Exchange must be permissible under the IRS code.
2. Insured and owner must be the same on both the old and new policies.

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3. Accepting policy must be a new policy. The old policy must be indicated on the replacement form as being replaced by this new policy.
4. To keep the exchange tax-free and arrive at the same cost basis in the new contract, the owner should not take receipt of the funds from the contract.

Q. I hear the term "Boot" used frequently when 1035 is being discussed. What does that mean?

A. Boot is often referred to in 1035s and refers to the value from an old contract that isn't transferred to a new contract. Boot may be taxable to the client if there was gain in the policy that they are 1035-ing into a new policy.

A "Boot" can be:

- Withdrawals of cash value by the client
- Loans that were not repaid, instead transferred to the new carrier, but do not mirror the loan at previous carrier.

Note: Transamerica and its financial professionals do not give legal or tax advice. Clients should consult their own legal and tax professionals.

Q. What if I submit a 1035 exchange form on a policy where the owner is different than on the new policy?

A. Owners must be the same between both policies. Otherwise, the 1035 would not be eligible for exchange without an ownership change. However, if the policy allows for ownership changes, then the 1035 would be eligible once ownership matches on both policies. **Note:** Name of owner and insured must match exactly.

Q. Can multiple individual life insurance policies be exchanged for a single policy?

A. Yes. But they must meet the four key requirements listed above, and a 1035 exchange form must be submitted for each policy that will be exchanged into the replacing policy.

Q. Can my client request a 1035 exchange into an existing/already in force policy?

A. No.

A 1035 exchange cannot be made after a policy has been issued if there was no intent to do a 1035 exchange reported on the original policy application. The only options available would be as follows:

- Leave both policies intact
- Surrender the policy your client wanted to terminate. All or some of the funds can be submitted to the policy desired. This would not be considered a 1035 exchange, and cost basis will not be transferred. It could potentially be taxable, will not transfer cost of insurance, and is subject to surrender penalties and more. Additionally, since the funds are applied as premium, this could result in the policy being considered a Modified Endowment Contract (MEC)*. The funds applied as premium may also be subject to Premium Expense Charges. Your client should seek the guidance of a tax professional before completing this type of transaction, to determine if it's in their best interest.
- Your client rejects the policy during the free look period (if eligible) and submits a new application for a 1035 exchange request. This could impact persistency and compensation. Transamerica and its financial professionals do not give legal or tax advice. Clients should consult their own legal and tax professionals.

Q. Can two single life policies, each insuring different lives, be exchanged for one second-to-die policy on both lives?

Can a second-to-die policy (also known as a "survivorship policy") be exchanged for two single life policies?

A. The IRS has ruled that exchanging two separate life policies for one second-to-die policy does not qualify as a valid 1035 exchange. However, if an individual has a second-to-die policy and one of the insureds is already deceased, the policy has only one insured (also known as a "survivorship policy"). An exchange from a survivorship policy to a single life policy under this circumstance is permitted.

* Modified endowment contracts are life insurance that were placed in force after June 21, 1988, and which fail to meet the 7-pay test.

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Q. Can a client do a 1035 exchange of a cash value policy into a new policy being created due to the conversion of a term policy?

A. Yes, they can simultaneously do a 1035 exchange and a conversion into one new policy in an integrated transaction. The product being converted to must be a product that can accept 1035 funds (e.g., FFIUL). This will require all the same documents/forms (replacement form, illustration, 1035 form) as you would need when submitting a new nonconversion application. The only difference is you would be submitting these with the conversion application.

Q. Does Transamerica allow partial incoming or outgoing 1035s?

A. No.

Q. Will a client who does a 1035 exchange get a Form 1099 during tax season?

A. Yes. A client who does a 1035 exchange will receive a Form 1099-R because the outgoing exchange amount and the cost basis of the original policy are reported to the IRS.

Internal 1035 exchanges will also result in a Form 1099-R.

Q. Can a client do a 1035 exchange that involves a foreign policy?

A. No, 1035 exchanges only apply to U.S. policies.

Q. Will my client get any tax forms because of a 1035 exchange?

A. For an outgoing 1035 exchange, a client will receive Form 1099-R with a code 6 in box 7, and a 0.00 (zero) taxable amount. This identifies the transaction as a 1035 exchange to the IRS. A second Form 1099-R will be issued if there is a Boot, showing the amount of taxable gain related to the Boot.

Q. Is a 1035 exchange the same as a conversion?

A. No, a conversion is guaranteed issue from a term to a permanent product. A 1035 is a tax-free exchange to a fully underwritten product that allows these tax-free exchanges. You can simultaneously do a 1035 exchange and a conversion into one new policy in an integrated transaction, but they are not the same type of transaction.

1035s AND LOANS

Q. My client has a loan on a policy from another carrier and wants to 1035 it into a Transamerica policy. Will Transamerica accept the loan, and can it still be exchanged?

A. No. Loans must be paid off before Transamerica accepts funds as part of a 1035 exchange. Transamerica doesn't permit Loan Rescues or mirroring of loans on 1035 exchanges. This includes internal exchanges as well.

Q. Will Transamerica disburse funds — to a different carrier as part of a 1035 exchange — from a policy with an existing loan?

A. Yes, but the 1035 exchange paperwork must clearly indicate that the other carrier is willing to carry over the loan. If carrying over the loan will cause a taxable gain, Transamerica will send a letter to the owner to confirm if they still wish to continue with the exchange.

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Q. What happens if my client uses the existing policy's cash value to repay a full or partial outstanding loan before doing the 1035 exchange?

A. This could be a taxable event. Your client could be taxed on the Boot to the extent of any potential gain in the contract. Transamerica and its financial professionals do not give legal or tax advice. Clients should consult their own legal and tax professionals.

1035s AND MECs

Q. My client was told that their 1035 exchange was making their policy a MEC. What can they do to resolve this?

A. First option

- Your client must complete a Letter of Intent (LOI) indicating they will accept the MEC.
- The LOI must have a signature from the client. The image of the LOI may be emailed, faxed, uploaded to portal, or mailed to us.
- We cannot accept an email written request by the client unless it includes an image of the signed LOI by client.
- Agent may not request an exception or waiver.
- The LOI cannot be accepted on delivery, it must be received prior to a policy being issued.
- Funds may be returned to the surrendering company if a completed LOI is not received.

Second option

- Request increase in coverage to avoid creating a MEC (UW would need to review and approve)

Q. Can a policy that is a Modified Endowment Contract (MEC) be exchanged for a new policy?

A. A 1035 exchange is allowed on policies considered a MEC. The new policy will also be a MEC, (Once a MEC, always a MEC).

SURRENDER PENALTIES

Q. Will Transamerica reimburse my client the surrender charges on their existing policy with another carrier and bring over the full cash value?

A. No.

We will not reimburse a client for any surrender charges or other fees that may have been charged for a 1035 exchange coming from another carrier. This is considered rebating and is prohibited.

ILLUSTRATIONS AND 1035s

Q. Am I required to submit a custom illustration for a policy that will receive funds as part of a 1035 exchange?

A.

- If a 1035 is part of the sales process, Transamerica will require a custom illustration.
- Upload either a wet-signed illustration, or an illustration created to be signed during the iGO® process.
  - Create an illustration in myTransWare℠ or WinFlex
  - Save illustration as a .pdf
  - Complete iGO application
  - Upload elected illustration
  - Electronically sign application; signature will be applied to illustration as well.
- Requirements may vary by state and are subject to change.

Q. Do I illustrate differently if the 1035 funds will be used for part or all of the client's premium payment(s)?

A. No. On the illustration, the 1035 "amount field" should match the amount of the 1035 funds that were received.

Q. How should I illustrate a 1035 exchange if 1035 exchange funds are not being used for the initial premium payment?

A. On the illustration, the 1035 "amount field" should match the amount of the 1035 funds that were received.

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Q. Why does the 7-pay on my illustration show the amount as zero? Explain how the 7-pay test works on a 1035 exchange.

A. The 7-pay test for a 1035 exchange computes how much of the new policy's death benefit is theoretically "paid-up" by the exchange funds. This amount is subtracted from the total death benefit and the remaining amount is the portion of the death benefit that is not "paid-up".

The 7-pay test is performed on the portion of the death benefit that is not "paid-up" to determine the amount of "new money" that can be paid into the contract each year. If the result of this calculation is negative, no new money can be paid into the contract.

* New money is considered premium or dump-in funds that are not part of the 1035 exchange amount.

1035 PROCESSING

Q. What is required to do an internal 1035 exchange to a new policy to waive surrender charges?

A. (FFIUL and FCIUL only) To waive surrender charges when they still apply and move an entire in force policy to a new policy (it is not the policy that is moved it is the cash value), the client must increase the face amount on the new policy by 25%, or more, above the in force policy's.

The following documents are required:

- New application
- The 1035 exchange form
- The applicable replacement forms
- Illustration showing the anticipated 1035 exchange funds prior to issuing a policy. An illustration with the final 1035 exchange funds amount will be provided by Transamerica and will need to be signed by the client.
    - For an internal 1035 exchange, Transamerica will need the 1035 funds prior to printing the policy (unless client is submitting premium to place the policy first) and will print the case with the batch illustration.
    - For an external 1035 exchange, Transamerica will place the case with the batch illustration and receive the funds after issue of policy. If a custom, signed illustration was received, and correct, it will be included with the contract. However, we will not be able to stop the batch illustration so they will receive both the batch and custom illustration in the contract.

Q. When does Transamerica solicit 1035 exchange funds?

A. This occurs on internal exchanges only.

- If approved as applied for, New Business will start the 1035 Exchange process to transfer the funds to the new policy.
- If other than applied for, New Business will notify the agent and wait for acceptance. Once acceptance is received, New Business will begin the 1035 Exchange process.
- New Business will notify the agent of the amount of 1035 funds to use when running the unsigned illustration.
- The unsigned illustration should be signed on delivery of the contract, either by eDelivery or wet-signed and returned via mail.

Q. When a 1035 exchange form is sent to an external carrier, how often is it followed up on by the processing team for a status?

A. Every seven to 10 days

Q. What is the average time it takes to receive 1035 exchange funds after Transamerica has requested the funds?

A.
- Internal 1035 exchanges: 7–10 business days
- External 1035 exchanges: 30 business days

Q. Does my client need to submit a withdrawal or surrender form when doing a 1035 exchange?

A. No. A withdrawal or surrender form **should not** be completed when doing a 1035 exchange from an external or internal policy.

Q. Are the 1035 forms on iGO?

A. Yes.



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Q. Can the client electronically sign the 1035 exchange form?

A.

- **Internal 1035 exchange/Application submitted via iGO** — If application was submitted via iGO, and the 1035 exchange is an internal 1035 exchange, then we will accept the electronically signed form that comes through iGO with the application.
- **External 1035 exchange/Application submitted via iGO** — Wet signature will be required. Most other carriers will not accept anything but a wet signature on outgoing 1035 exchanges. We recommend you get the 1035 exchange form wet-signed and attach to the iGO application before submitting.
- **Internal 1035 exchange/Paper application** — Wet signature is required.
- **External 1035 exchange/Paper application** — Wet signature will be required. Most other carriers will not accept anything but a wet signature on outgoing 1035 exchanges.

Q. How do I complete the Absolute Assignment section of the 1035 exchange form?

A. There are two boxes on the form. (See screenshot below).

Check the first box if:

a. You need to fill out all information for the Surrendering Company on the top of the form.

b. It's a type of existing policy.

Note — by checking this box:

a. Transamerica will not proceed with the 1035 exchange if there's an outstanding loan on the existing policy.

b. Transamerica will disclose the amount of the loan.

c. Transamerica will disclose the taxable income amount.

Check box 2 if:

a. There is a loan on the original policy.

b. The client is OK with doing the 1035 exchange without first learning the taxable income amount and loan amount.

Note — by checking this box:

- Transamerica will proceed with the 1035 exchange.
- The exchange will happen even if there is a loan that results in taxable income.

ABSOLUTE ASSIGNMENT TLIC Policy Number: _____

The above listed policy has been assigned to the Insured selected above (the "Company) In exchange for the TLIC policy to be issued by the company. It is intended that this will qualify as a tax-free exchange within the provisions of the Internal Revenue Code, Section 1035. Consequently, the policy issued by the Company will have the same Insured/Owner designations as the policy issued by the existing company. The Company assumes no responsibility or liability for the tax treatment under Internal Revenue Code Section 1035.

If your policy has an outstanding loan prior to the exchange, the Company will not issue a new policy with an outstanding loan. The Company will, however, process a 1035 Exchange on a policy transferring the net cash value (cash value less any loans). However, any policy loan that exists prior to the exchange, is discharged. This constitutes the receipt of income which is taxable, and subject to gain, to the extent of the loan (Reg.1.103(b)-1(c).

☐ If there is an existing policy loan, which would result in taxable income, please do not proceed with the surrender. Please advise us of the amount of the loan and the amount of taxable income.

☐ If there is an outstanding loan which would result in taxable income, please proceed with the surrender.

POLICY STATEMENT

☐ My policy/contract is attached

☐ My policy/contract is lost

TAX

☐ Please withhold Federal Income Tax

☐ Please DO NOT withhold Federal Income Tax

The undersigned hereby assign and transfer/surrender all right, title and interest in the above policy to the Company P.O.Box. Please make the check payable to the insurer selected below.

Note: All sections need to be checked and filled out on Absolute Assignment form.

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Q. My client wants to take a withdrawal from their external policy before starting a 1035 exchange into a Transamerica policy, or from a Transamerica policy to an external policy. Is this a taxable event?

A. This could become a taxable event. Please encourage your client to consult a tax professional for guidance.

Q. Can my client take a withdrawal after the 1035 exchange is complete and their new Transamerica policy is active?

A. This would follow normal withdrawal procedures and could result in a taxable event. Please encourage your client to consult a tax professional for guidance.

MISCELLANEOUS 1035 EXCHANGE QUESTIONS

NEW YORK/REGULATION 60

Q. If I am writing an application in New York, are there any special rules that I need to follow for a 1035 exchange?

A. Any replacement in New York is governed by Regulation 60 and as such, the regulation must be adhered to.

CONTESTABILITY PERIOD

Q. Will a Transamerica policy accepting 1035 exchange funds retain the contestability period of the policy it replaced?

A.

- Internal replacements — Only the additional financial risk is contestable if the original policy was outside of the contestability period. For example, if a policy with a face amount of $100,000 replaces a policy with an incontestable policy with a face amount of $25,000, $75,000 of the face amount of the replacement policy is subject to the policy's contestability provision.
- External replacements — Generally, the entire face amount of the new policy is subject to the policy's contestability provision. However, the laws or regulations of certain states require Transamerica to treat external replacements similarly to internal replacements for the purposes of contestability. Currently, such states include Kansas, Kentucky, and West Virginia.

Q. Can my client free look the new policy and have the 1035 exchange funds returned to the carrier from which they were received? Will Transamerica reinstate a policy where funds were sent to another carrier as part of a 1035 exchange?

A. Once a policy is surrendered, the carrier will not accept the funds back. Transamerica will not reinstate a policy where funds were sent to another carrier as part of a 1035 exchange. It is imperative that a client fully understands the consequences of the transaction involving the 1035 exchange, as they will be unable to restore the replaced policy.

PREMIUM

Q. My client is using the 1035 exchange funds to pay their initial premium. Are they eligible for Conditional coverage?

A. To elect Conditional coverage, one must meet the guidelines outlined on the application, which include premium to be submitted WITH the application. As funds received via a 1035 exchange are received AFTER the application was submitted, clients using 1035 exchange funds to pay their initial premium are not eligible for Conditional coverage.

Q. Can the client use 1035 funds to pay for initial premium payment?

A. Yes. Your client should exercise caution when subsidizing the Minimum No Lapse Premium (MNLP) with 1035 exchange funds. There could be insufficient premium to maintain that MNLP. It will depend on the illustration solve that you elect when running the illustration.

Q. Do I need to alert the external carrier the 1035 exchange funds will be coming from the transfer that will be occurring?

A. No. If applicable, Transamerica will notify them of the replacement when the completed replacement form is received.

Q. Can I backdate the Policy Date to save age when doing a 1035 exchange?

A. No. Transamerica does not permit backdating the Policy Date to save age when a 1035 exchange is involved.

Q. What funds will be transferred in an external 1035?

A. The surrender value — cash value minus any penalties or indebtedness (loans)



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TOP REASONS A 1035 DOESN'T GO SMOOTHLY

Outgoing 1035 exchanges to an external carrier:

1. Missing additional requirements (Release of collateral assignment, Letter of Intent, Corporate Resolution, etc.)
2. Social Security number is incorrect.
3. Paperwork is not filled out correctly, i.e., wrong distribution checked.
4. Signatures do not match.
5. Paperwork is dated over 90 days or more.

Incoming 1035 exchanges:

1. The 1035 exchange form is not completed correctly.
2. Owner/insured is not the same on the old and new policies.
3. The 1035 exchange form is dated 90 days or more.

Internal 1035 exchanges:

1. The 1035 exchange form is not completed correctly.
2. Owner/insured is not the same on the old and new policies.
3. The 1035 exchange form is dated over 90 days or more. In force case has a collateral assignment and release of assignment is needed on file before the 1035 funds can be released.

HOW DO I CONTACT YOU?

Incoming 1035/internal 1035 statuses:

1. Brokerage/General Agency/Direct Markets/Institutional
   - 877-234-4848 option 1
   - nb@transamerica.com
2. TAN
   - 410-223-4485
   - tancanewbusiness@transamerica.com
3. WFG
   - 800-322-3796 ext. 1236582
   - TPLIClifenewbusinesswfg@transamerica.com

Outgoing 1035 status/existing policy 1035 eligibility:

All distribution groups: 800-851-9777

1. Brokerage/General Agency/Direct Markets/Institutional
   - tii.customerservice@transamerica.com
2. TAN
   - mlscdistrictemail@transamerica.com
3. WFG
   - elifecustomersupport@aegonusa.com

Pre-sales assistance with 1035s:

1. Brokerage/General Agency/Direct Markets/Institutional
   - 866-545-9058
2. TAN
   - 410-223-4485 option 6
3. WFG
   - 800-322-3796 option 6

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