1035 EXCHANGE INSTRUCTIONS

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SECTION 1035 TAX FREE EXCHANGES

A Section 1035 Tax-Free Exchange eliminates taxation to the Contract Owner when their intent is to exchange one insurance contract for another better suited to their needs. The exchange of funds occurs from one company to another. The check must be payable to the company that is either issuing a new contract or accepting the funds into an existing contract. If the check is made payable to the individual and endorsed over to the new company, a 1035 Exchange is not accomplished and the Contract Owner will have to pay taxes on the gain in the old contract.

The following are types of exchanges permitted under Section 1035:

1. A **life insurance policy** can be exchanged for another **life insurance policy**, **endowment policy** or **nonqualified annuity.**
2. An **endowment policy** can be exchanged for another **endowment policy** or **nonqualified annuity**. An endowment policy cannot be exchanged for a life insurance policy.
3. A **nonqualified annuity** can be exchanged for another **nonqualified annuity**.

An additional requirement is that the Annuitant or Insured on the new contract must be the same as that on the old contract. Two or more existing insurance contracts may be exchanged for one new contract, or vice versa. Or, a contract may be exchanged and the funds from the contract may be placed in a previously issued contract.

Even though a nontaxable event occurs, the Internal Revenue Service requires that a 1099R be issued for informational purposes on an exchange (none is required if the exchange is within the same company).

In order to affect a true tax-free exchange, the existing contract cannot have a loan outstanding. The loan must be repaid prior to the exchange. If not, the loan is taxed as income received to the extent of any gain in the contract. Taxation can also occur if any of the proceeds of the exchange are used as advance premiums on the new contract. The amount of money placed in advance premiums will be taxed as income to the extent of any gain in the contract. Also, any cash refunded with an exchange is taxable to the extent of the gain in the contract exchanged.

The following procedures should be followed when handling a 1035 Exchange for your client:

1. The Contract Owner assigns the existing contract to us using the Transfer/1035 Exchange Form ET-TRN/1035/4092.
2. The agent completes the Application for the appropriate contract, or indicates which existing contract should receive the 1035 proceeds. (Please enter the number of the existing contract on the form where indicated). **Keep in mind that all insurance contracts contain a provision that the Company can withhold surrender proceeds for a period of six months.**
3. The agent sends us the completed Application, 1035 Exchange Form, old contract and appropriate replacement forms, if required.
4. After all issuing requirements are met, we send the old contract, 1035 Exchange Form and surrender request to the old company to have the proceeds transferred directly to us to be applied to the new contract. If the 1035 Exchange will be into an existing contract, the 1035 Exchange Form and surrender request will be sent to the old company within a reasonable time after they are received.
5. The old company sends the surrender check to the new company together with cost basis information on the old contract being exchanged.
6. The surrender value of the old contract is applied to the new contract (or existing contract) and the cost basis information from the old contract is added to the new contract record. If the new contract is later surrendered, the Contract Owner will be taxed on the gain carried forward from the old contract as well as the gain on the new contract.
7. If this is an internal exchange (one of our contract's for a new contract) we will not require an assignment. Indicate on the application that this is an exchange and complete the Internal Transfer/Exchange Request Form ET-INT-TRANS. More information can be found in the Internal Transfer Program document ET-INTERNALTRANSFER.
8. Insurance department replacement regulations and company replacement commission rules apply to all Section 1035 Exchanges. Caution should be used before suggesting an exchange of an existing contract for a new one as it is not always in the best interests of the contractholder to replace existing insurance.
9. Once the contract is issued it is sent to the Agent for prompt delivery to the Contract Owner(s).

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