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## Exchanges for Long Term Care Insurance Policies

Can you exchange a life insurance policy or deferred annuity contract for a long term care insurance policy under Internal Revenue Code (IRC) §1035? No, but you can exchange a life insurance policy or deferred annuity for a single premium immediate annuity (SPIA). The after-tax income from the SPIA can help pay the LTCI policy premiums.

This strategy is similar to those using non-life insurance products, like certificates of deposit or mutual funds, discussed in our bulletin, [LTCI + SPIA = A Dynamic Combination](#).

There can be some advantages to an IRC §1035 exchange using a life insurance product:

- If the customer needs long term care insurance more than life insurance or a deferred annuity, this strategy helps them address that need
- None of our long term care insurance policies can be paid for with a single premium, so this strategy may be an alternative
- During any period that the customer is on claim and the waiver of premium is in effect, SPIA income could instead supplement the benefits available under the LTCI contract
- An IRC §1035 exchange can be done on a tax-free basis, while surrendering an asset with unrealized capital gains (like a mutual fund) may trigger capital gains tax

However, there are some important things to keep in mind about such an exchange:

- When exchanging a life insurance policy for a SPIA, be sure that you can justify the exchange if the customer's heirs are disappointed at not receiving a large life insurance policy death benefit
- The exchange is irreversible. Be sure that your customer no longer needs the life insurance policy or deferred annuity contract being exchanged.

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- LTCI premiums may rise in the future. This strategy cannot guarantee that the customer will never have to pay LTCI premiums again.
- If the customer lives to their life expectancy, all the SPIA income will be taxed after that point as ordinary income. Further, income tax rates may rise in the future, thereby decreasing after-tax SPIA income. In that case, other income sources may have to be used to help pay LTCI premiums.

Also, carefully consider some alternatives to exchanging a life insurance policy:

- Your customer may be able to access cash values from a universal life insurance policy to pay some or all of the LTCI premiums without exchanging the life insurance policy. The life insurance policy death benefit will be smaller, and the life insurance policy will have to be monitored to ensure that its cash value can still support the policy.
- Have a relative take over the life insurance policy premium payments, thereby freeing money to pay LTCI premiums. Although it is beyond the scope of this bulletin, a split dollar arrangement may make sense. It could be structured to pay the relative their premiums back at the customer's death.
- A relative could also pay your LTCI premiums. The eligible (age-based) premiums would not be subject to gift tax, nor would the donor have to use any of their annual exclusion.

No one should lightly consider giving up a life insurance policy or deferred annuity contract. At the same time, a customer's financial plan contains many elements. Think about all the elements in your customer's financial plan, and consider your customer's needs and how best to satisfy them.

Long Term Care Insurance is underwritten by Genworth Life Insurance Company.