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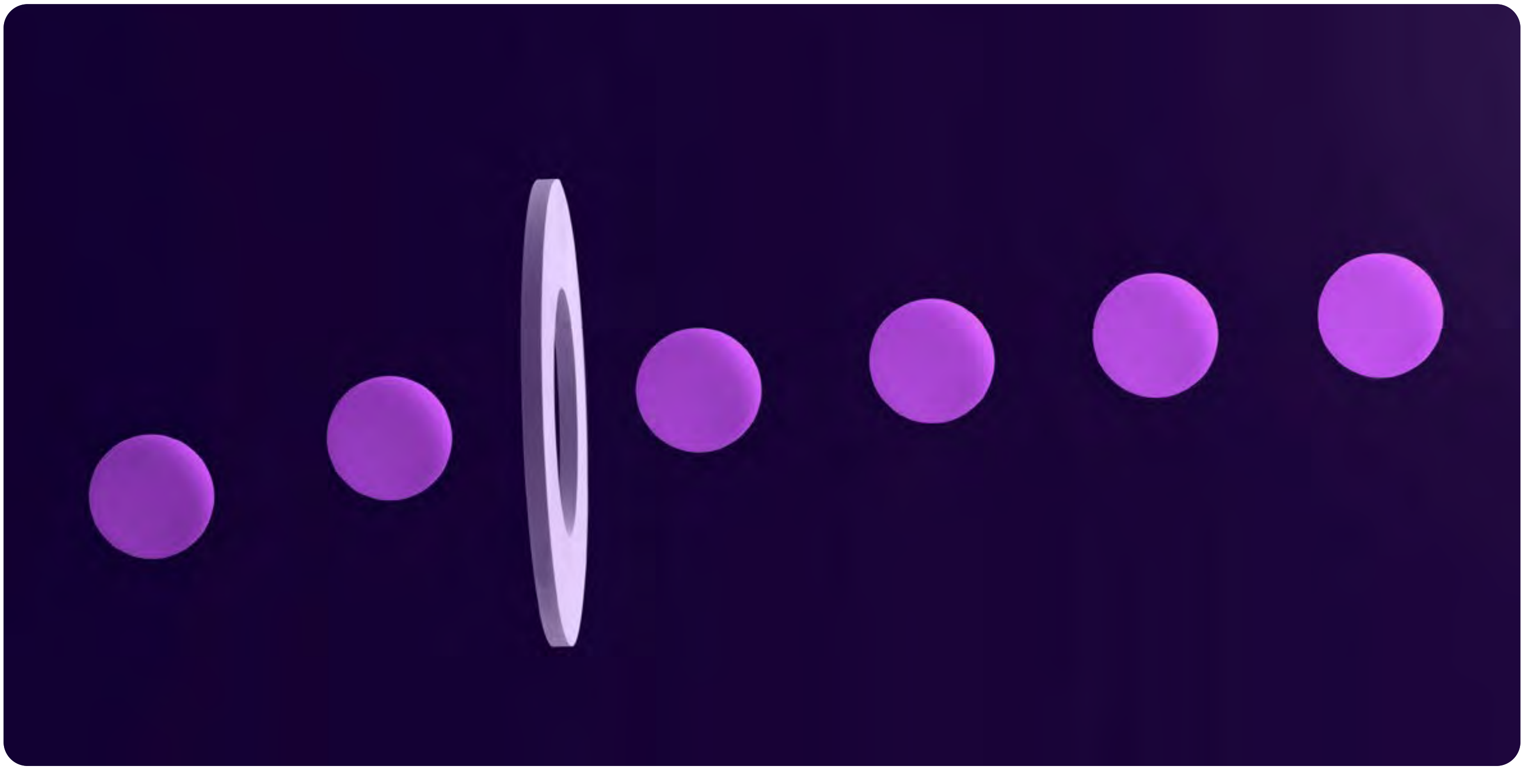

Understanding Partial 1035 Exchanges

When a client wishes to fund another annuity with a portion of his or her non-qualified annuity, he or she may wish to execute a partial 1035. Much like a full 1035 exchange, if structured correctly, the partial section 1035 exchange option allows for a tax-free transfer of cash value from one non-qualified annuity to another while preserving the tax-deferred status of both the older, contributing contract, and the new, receiving contract.

Certain rules must be followed to maintain the tax-advantaged nature of the contracts involved. If the client does not follow these rules exactly, the IRS may deem the 1035 exchange to be invalid, and tax the exchanged amount as a distribution.

Understanding Partial 1035 Exchanges

180-Day Waiting Period

180 DAYS

Revenue Procedure 2011-38 implements a 180-day period in which distributions may not be taken from either the surrendering contract or the receiving contract. Distributions taken within this 180-day window are subject to heightened IRS review and may result in taxes, penalties, and fees.

There is one exception to the 180-day rule: If the receiving contract is an immediate annuity for one or more lives or for a period certain of 10 or more years, then distributions may be made from the immediate annuity within the 180-day window without violating the rule.

Funds Must Transfer from Institution to Institution

The funds comprising the 1035 exchange amount must be sent directly from the surrendering insurance carrier to the receiving insurance carrier with like-for-like titling. Should the contract owner take receipt of the funds at any time between when the surrendering carrier surrenders the funds and when the receiving carriers receives the funds, the exchange will lose its tax-deferred status and will be deemed a distribution.There is no such thing as an indirect 1035 exchange.

Pro Rata Rule Partial 1035 Earnings Ratio Considerations

The funds used in a partial 1035 exchange maintain the earnings-to-basis ratio of the surrendering contract. Put another way, the basis and earnings will be split pro-rata between the contracts. Let’s look at an example.

Partial 1035 Exchange Considerations

Pro Rata Rule Partial 1035 Earnings Ratio Considerations—continued

Let's say you have a client who purchased a variable annuity with a premium of $100,000. After several years' time, the annuity has grown to a contract value of $150,000. Now, let's say this client wishes to execute a partial 1035 exchange in the amount of $75,000.

Deferred Annuity 1	
immediately preceding the partial 1035 exchange	
Cost Basis:	$100,000
Earnings:	$50,000
Contract Value:	$150,000

Action: Partial Exchange of $75,000 from old contract to new contract

Each annuity immediately following the partial 1035 exchange			
Deferred Annuity 1		Deferred Annuity 2	
Cost Basis:	$50,000	Cost Basis:	$50,000
Earnings:	$25,000	Earnings:	$25,000
Contract Value:	$75,000	Contract Value:	$75,000

Considerations

Determine client's income needs, as a partial 1035 exchange may not be appropriate for some clients.

Should the annuity owner take a withdrawal within the 180-day period, the IRS may apply general tax principles and may result in adverse tax consequences.

To learn more, contact your Corebridge Financial Distributors wholesaler or call our Sales Desk at 1-888-502-2900

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M3308FL (06/24)