PPA Compliant Annuity: Solving Hidden Tax Problems

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A PPA compliant annuity lets clients move tax-deferred annuity or life insurance cash value gains into a policy that pays for long term care completely tax free, turning a growing tax liability into paid up LTC coverage.

The past 15+ years have rewarded clients whose investments have market exposure. Since the 2009 bottom, the S&P 500 has seen one of the longest bull markets in history.

That growth is great news for clients' portfolios and their retirement outlook. But for clients using tax-deferred vehicles like annuities or cash value life insurance, it also means a quietly growing tax liability they may not realize they have. The Pension Protection Act (PPA), in effect since 2010, offers a way to address that tax exposure while solving a more pressing planning need: Long Term Care coverage.

What is a PPA Compliant Annuity?

A PPA Annuity or [LTC Annuity] is simply a deferred annuity that allows for tax advantaged distributions when funds are used to pay for long term care claims. They can be structured in a few different ways, offering flexibility to accumulate as much cash value as possible, or to buy as large a total pool of LTC benefits as possible.

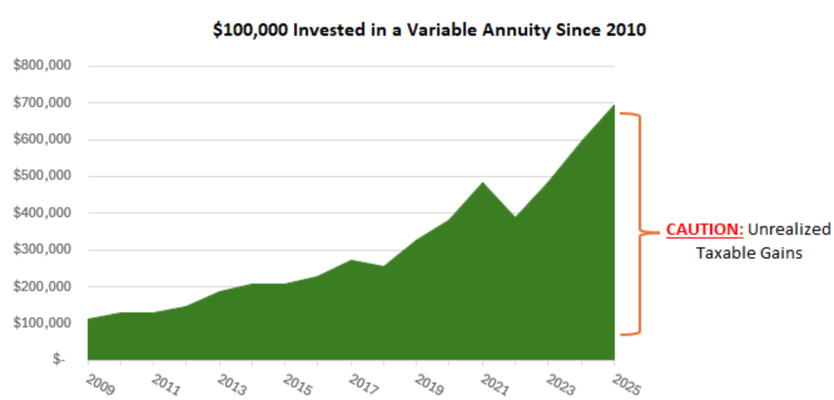
How can a 1035 exchange defuse a tax time bomb?

A 1035 exchange lets clients move the taxable gains sitting inside an old annuity or life insurance policy into a PPA-compliant LTC annuity completely tax free, without triggering the tax bill a surrender or straight withdrawal would create. That's the difference between watching a growing gain turn into a tax liability and turning that same money into tax-free long-term care coverage.

Here's how that decision played out for a real couple.

Case Study — Bob & Mary

Bob & Mary bought a variable annuity in 2009 with a $100K single premium. They selected growth focused subaccounts at issue and left the policy alone to accumulate for a rainy day. Now that they are in their 70s and considering the possibility of Long Term Care needs, Bob and Mary are thinking about how to best utilize their policy. A recent review with their advisor brought up an issue they had not fully considered - taxes.



While Bob & Mary's policy has performed quite well since inception, growing from $100K to more than $650K, they had not realized that the money in the policy does not fully belong to them. Not only is the $550K of unrealized gains fully taxable at income tax rates, that portion of the funds is the first to come out of the policy due to last in, first out (LIFO) distribution rules.

> *Consider income tax brackets for the surviving spouse! After Bob or Mary passes, the remaining survivor will pay income taxes on distributions at less favorable individual income tax rates.*

While Bob and Mary were thrilled about the growth in their policy, they were even more pleased that their advisor had a solution to help them keep more of that money. They decided to execute a 1035 to a PPA compliant long term care annuity. Despite being in their 70s, and not having the best health, a PPA compliant LTC Annuity can help solve both their tax and LTC planning objectives.

		PPA Compliant Long Term Care Annuity Projected Values				Current Variable Annuity Projected Values- 7% Gross Crediting Rate*				
Year	Ages (m/f)	Annual Premium	Cash Surrender Value	Income Tax-Free LTC Benefit Pool	Monthly Income Tax-Free LTC Benefit	Beginning of Year Value	End of Year Account Value	Taxable Gain net of 24% Tax (Distributed First)	Tax-Free Portion of Cash Value (Distributed Last)	Total Net Cash Value
1	73 / 71	$ 650,000	$ 620,779	$ 688,997	$ 22,967	$ 650,000	$ 690,300	$ 448,628	$ 100,000	$ 548,628
2	74 / 72	$ -	$ 658,667	$ 730,262	$ 24,342	$ 690,300	$ 733,099	$ 481,155	$ 100,000	$ 581,155
3	75 / 73	$ -	$ 665,827	$ 737,421	$ 24,581	$ 733,099	$ 778,551	$ 515,699	$ 100,000	$ 615,699
4	76 / 74	$ -	$ 706,299	$ 781,437	$ 26,048	$ 778,551	$ 826,821	$ 552,384	$ 100,000	$ 652,384
5	77 / 75	$ -	$ 749,146	$ 828,004	$ 27,600	$ 826,821	$ 878,084	$ 591,344	$ 100,000	$ 691,344
6	78 / 76	$ -	$ 794,505	$ 877,266	$ 29,242	$ 878,084	$ 932,525	$ 632,719	$ 100,000	$ 732,719
7	79 / 77	$ -	$ 802,781	$ 885,542	$ 29,518	$ 932,525	$ 990,341	$ 676,660	$ 100,000	$ 776,660
8	80 / 78	$ -	$ 851,205	$ 938,062	$ 31,269	$ 990,341	$ 1,051,743	$ 723,324	$ 100,000	$ 823,324
9	81 / 79	$ -	$ 902,455	$ 993,612	$ 33,120	$ 1,051,743	$ 1,116,951	$ 772,883	$ 100,000	$ 872,883
10	82 / 80	$ -	$ 956,694	$ 1,052,363	$ 35,079	$ 1,116,951	$ 1,186,202	$ 825,513	$ 100,000	$ 925,513
11	83 / 81	$ -	$ 1,004,050	$ 1,114,496	$ 37,150	$ 1,186,202	$ 1,259,746	$ 881,407	$ 100,000	$ 981,407
12	84 / 82	$ -	$ 1,053,750	$ 1,180,201	$ 39,340	$ 1,259,746	$ 1,337,850	$ 940,766	$ 100,000	$ 1,040,766
13	85 / 83	$ -	$ 1,053,750	$ 1,190,738	$ 39,691	$ 1,337,850	$ 1,420,797	$ 1,003,806	$ 100,000	$ 1,103,806
14	86 / 84	$ -	$ 1,105,911	$ 1,260,739	$ 42,025	$ 1,420,797	$ 1,508,887	$ 1,070,754	$ 100,000	$ 1,170,754
15	87 / 85	$ -	$ 1,160,654	$ 1,334,752	$ 44,492	$ 1,508,887	$ 1,602,438	$ 1,141,853	$ 100,000	$ 1,241,853
16	88 / 86	$ -	$ 1,218,106	$ 1,400,822	$ 46,694	$ 1,602,438	$ 1,701,789	$ 1,217,359	$ 100,000	$ 1,317,359
17	89 / 87	$ -	$ 1,218,106	$ 1,400,822	$ 46,694	$ 1,701,789	$ 1,807,300	$ 1,297,548	$ 100,000	$ 1,397,548
18	90 / 88	$ -	$ 1,278,402	$ 1,470,163	$ 49,005	$ 1,807,300	$ 1,919,352	$ 1,382,708	$ 100,000	$ 1,482,708
19	91 / 89	$ -	$ 1,341,683	$ 1,542,936	$ 51,431	$ 1,919,352	$ 2,038,352	$ 1,473,147	$ 100,000	$ 1,573,147
20	92 / 90	$ -	$ 1,408,097	$ 1,619,311	$ 53,977	$ 2,038,352	$ 2,164,730	$ 1,569,195	$ 100,000	$ 1,669,195

*7% Gross crediting rate less 0.8% annual expenses

After crunching the numbers with their advisor, Bob & Mary see that executing a 1035 to the LTC annuity will net them more money during the period they are likely to have a care event than their variable annuity would. The money they would have otherwise spent on taxes can now be used to pay for care, effectively turning a liability into an asset.

Here's an example:

At Bob's age 80 he has a health event and needs to move into a private room in a care facility temporarily which costs $15,000 per month.

- With the PPA Compliant LTC annuity, a $15,000 claim is paid, and the benefit pool is reduced by $15,000.
- Had they not exchanged their current policy, they would need to take a gross policy distribution of $19,737 per month to net the same $15,000 after taxes (assuming a 24% effective tax rate). Over the course of a year, the $56,842 in additional taxes they would be liable for could have paid for nearly 4 months of care!

How fast is the process to get covered?

The process of issuing the PPA compliant annuity is fast and painless:

1. Your clients will complete an e-app online and sign electronically
2. Coverage may be issued based on 4 yes/no questions, there is no drawn-out underwriting process

   5. Do you currently use any of these mechanical devices: wheelchair, walker, dialysis machine, oxygen equipment, respirator, stair lift, chair lift, or motorized scooter?..........
   6. Do you currently need or receive help in doing any of the following: bathing; eating; dressing; toileting; transferring into and out of a bed, chair, or wheelchair; and/or maintaining continence?..........
   7. Do you currently have, or have you ever had a diagnosis of, or been treated for: Alzheimer's disease, dementia, or memory loss? Multiple sclerosis, muscular dystrophy, ALS (Lou Gehrig's disease), or Parkinson's disease?..........
   8. Have you ever been diagnosed as having or been told by a medical doctor that you have AIDS, HIV, or ARC disorders, or tested positive for antibodies for the AIDS virus?..........

3. A 1035 exchange between insurance companies takes place with no tax implications for the client
4. Coverage is inforce as soon as funds are received

How can an unneeded individual life insurance policy fund LTC benefits for two people?

A life insurance policy that no longer fits a client's needs (one that's outlived its original purpose or doesn't match their current situation) can be 1035 exchanged into a PPA compliant annuity and structured to cover a spouse or partner as well, turning an unused asset into a shared pool of tax-free long term care benefits for both lives.

Here's how that played out for one couple.

Case Study — Jake & Kristi

Jake has an inforce whole life insurance policy that was written years ago before he married his partner, Kristi. Since he is no longer single, his planning has become more complicated, and the whole life policy does not fit his current needs.

The death benefit is not especially meaningful relative to the income replacement need, and the cash value would not generate significant income for the couple. Prior to meeting with his advisor, Jake had been thinking about surrendering the policy for about $250K in gross cash value with $175K in taxable gains.

Instead of surrendering the policy, the advisor suggested a 1035 exchange to a PPA compliant annuity product and adding Kristi to the new policy to yield tax free LTC benefits available for both clients.

Because both Jake and Kristi are in good health, each of them are willing to complete a phone interview (in addition to the 4 knockout questions) to obtain a policy with a 90-month shared benefit pool that they both can access.

With the advisor's help, the unneeded individual insurance policy was exchanged tax free and required no additional contributions to create a shared pool of meaningful LTC benefits.

Before Exchange to PPA Compliant Annuity

- $400K of death benefit on Jake's life
- $250K of cash value with $175K of taxable gains

After Exchange

- Joint Coverage for Jake & Kristi (shared 90 month benefit pool)
- Year 1: $5,100 initial monthly LTC benefit amount, $475K of LTC benefit pool
- Age 80: $9,500 monthly benefit, $845K of LTC benefit pool

Jake & Kristi were able to leverage an unused and unwanted asset to create a larger pool of tax-free long term care benefits covering both lives with no additional outlay or taxable event.

What support does a client get once they're on claim?

The insurance company's role in this process does NOT stop after the policy has been issued. When your client goes on claim, they will receive personalized support from a dedicated point of contact at the carrier who will help with all that comes next, including:

- Providing information about policy coverage and benefits and the claims process
- Providing information about services and providers where your clients live
- Coordination with the care facility and providers on your clients' behalf

What This Means for Advisors

With annuity sales breaking records year after year, there are lots of replacement opportunities available to address a variety of client planning needs. You can help educate your clients about future liabilities and recommend a solution with a quick and painless process. If you're not talking about this solution with your clients, someone else will. SPG Life & Annuity's case design team knows this product space inside and out and is ready to help you spot these opportunities and structure the right solution for every client.

Start a Policy Review!

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