IRS seeks discussion on annuity – LTC hybrids

By Editor Test *Tue, Aug 16, 2011*

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The Internal Revenue Service (IRS) has issued Notice 2011-68, which discusses the tax rules that apply to annuity-long term care (LTC) benefits hybrids and exchanges of annuity cash surrender value for qualified LTC insurance, *National Underwriter* reported. The IRS also asked for public comment on the matter.

Tax experts at the American Council of Life Insurers (ACLI), Washington, asked the IRS put those issues on its 2011-2012 guidance priority list two months ago.

Section 1035 of the Internal Revenue Code (IRC) has been letting taxpayers trade in life and annuity products for other life and annuity products tax-free for many years. A provision in the Pension Protection Act of 2006 added IRC Section 844, which lets taxpayers get or dispose of LTC policies through tax-free Section 1035 exchanges.

Although taxpayers are allowed to make the exchanges, they have not been sure how to report the exchanges, or how the exchanges might affect their income taxes, the ACLI tax experts told the IRS in a comment on the IRS guidance development priority list. The ACLI asked the IRS to confirm that premiums paid for annuity-LTC combination product are included in the investment in the contract.

The Treasury Department and Internal Revenue Service request comments on the following related issues:

- What issues arise when the owner of an annuity contract with a long-term care insurance feature decides to annuitize the contract? Are the policyholder’s rights under the long-term care insurance feature typically the same or different before and after the annuity starting date? How should long-term care insurance charges be accounted for after the annuity starting date? How should the exclusion ratio be determined?
- For the purpose of determining whether the long-term care features of an annuity contract qualify as an insurance contract and thus as a qualified long-term care insurance contract, what is the appropriate characterization of long-term care payments that cause a reduction in a contract’s cash value? Are there common features or contract designs that would lend themselves to guidance on determining whether enough insurance risk is present for the long-term care features to qualify as an insurance contract?
- Is guidance needed on the partial exchange of the right to some or all of the payments under an immediate annuity contract for a qualified long-term care insurance contract? If so, how is such an exchange effected? Under what circumstances should such an exchange be treated as tax-free under § 1035? How should the basis and investment in the contract be apportioned between the qualified long-term care insurance contract received in the exchange and the rights still held in the exchanged annuity?
- What changes, if any, are needed to existing guidance (including publications, forms, and instructions) on information reporting and record keeping to assist issuers of life insurance, annuity,

> or qualified long-term care insurance contracts in meeting their obligations with regard to the amendments made by section 844 of the PPA?

Written comments should be submitted by November 9, 2011 and should refer to Notice 2011-68. Submit comments to CC:PA:LPD:PR (Notice 2011-68), Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044, or electronically to *Notice.Comments@irscounsel.treas.gov*. Include “Notice 2011-68” in the subject line of the email.