Is the exchange of life insurance policies for annuities a tax-free exchange?

The IRS has concluded that the exchange of two nonparticipating flexible premium life insurance policies, each issued by a different life insurance company, for a single nonparticipating flexible premium variable annuity contract, issued by a third life insurance company, is a proper IRC Section 1035 exchange. The IRS agreed that the annuity could be initially issued in the amount of the proceeds received from the first policy and then increased in value when the proceeds of the remaining policy arrived.[[1]](#footnote-1)

When a life insurance policy was exchanged for an annuity plus an additional cash payment, the IRS concluded that the exchange qualified for IRC Section 1035 treatment. The additional cash payment into the newly-issued annuity was needed to meet the annuity’s minimum premium requirement. Further, noting that administrative delays should not convert a tax-free exchange to a taxable one, the IRS concluded that if the two amounts were not received at the same time, the insurance company could issue the annuity in an amount equal to the cash payment and then later increase the value of the annuity when the funds from the life insurance policy were received.[[2]](#footnote-2)

1. Let. Rul. 9708016. [↑](#footnote-ref-1)
2. Let. Rul. 9820018. [↑](#footnote-ref-2)