

## OAKLAND BUSINESS / Finance

## Annuity exchanges can be tax-free



**MORE THAN MONEY**  
SID MITTRA, Ph.D.  
As a general rule, the sale of an investment constitutes a taxable event, even when the sale proceeds are immediately reinvested. However, the law allows an important exception to this rule. This exception is discussed in this article.

The Internal Revenue Code Section 1035a allows for "Certain Exchanges of Insurance Policies." The code provides that there will be no gain or loss recognized on the exchange of:

1. A life insurance contract for another life insurance, endowment or annuity contract;

2. An endowment contract for another endowment contract with a maturity date no later than the maturity date of the original contract, or for an annuity contract;

or 3. An annuity contract for another annuity contract.

Any other type of exchange is treated as a taxable event with all gains and losses being taxed at the year of the exchange. Incidentally, moving from a variable to a fixed annuity or from a fixed to a variable annuity, is considered a tax-free exchange as long as it falls under one of the three transactions listed above.

To effect a tax-free exchange, some very important rules must be followed. First, the owner of the contract must absolutely assign the value of the existing contract to the new carrier. This prevents the client from depositing the money in a checking account and writing a new check to the insurance company. If a client takes "constructive receipt" of the funds, the gain becomes taxable in that year. There is, however, specific relief for this method in cases where the existing carrier is in rehabilitation.

Another very important part of the exchange process is maintaining the same parties to the contract (i.e., owner and annuitant/insured). If either of these parties changes, the transaction will not

qualify as a tax-free exchange. The contract, as it is set up today, must be transferred in full to the new carrier. Partial exchanges are not allowed under section 1035(a).

Unfortunately, Section 1035a does not address all aspects of exchanges, thereby leaving many "gray areas" subject to IRS interpretation and possible adverse tax implications. Among those areas is the issue of exchanging multiple annuity contracts into a single new annuity. The language included in Section 1035a says that "exchanging an annuity contract for another annuity contract" will be considered a tax-free exchange. Therefore, an exchange of multiple annuity contracts for one may be considered "risky" since it is not specifically addressed in the language describing tax-free exchanges.

Many items must be examined before determining if a Section 1035(a) exchange makes sense. Among these are:

- needs of the owner;
- risk tolerance level;
- market outlook and interest rate environment;

■ product performance; product features and costs; quality of services and costs involved in the transaction (surrender charges or interest rate adjustments);

■ underwriting considerations (life insurance only); and

■ carrier's quality and ratings. Some of these items can be addressed by making changes to the current contract. A thorough investigation of all available options with the existing carrier as well as examination of alternative products is highly recommended.

So, it appears that 1035 exchanges do make sense for some annuity and life insurance owners when good judgment is exercised.

*Sid Mittra, Ph.D., CFP, is professor of finance, Oakland University, Rochester Hills, and owner, Mittra & Associates, a Troy financial consulting firm. This column was critically reviewed by Professor Gerald Grossman, Oakland University. You can e-mail questions or comments to Sid Mittra, Ph.D., CFP at smittra@oconline.com.*



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**JOB SEARCH**  
GEORGE HAYES  
A similar site will take your Zip Code and return the address and congressional district of that representative. Point to <http://www.stardot.com/zipper>. This is from any direct marketing effort. In employment, count on zero to one-third of all leads generated to be worth pursuing. Using this math, if you mailed out 1,000 unsolicited resumes, you could find up to 10 viable openings. Maybe not so bad. Then again, you could come up with nothing.

The odds could be improved by using a mailing list that identifies managers by name (avoiding personnel departments) and companies that would logically have an interest in you. If you have skills that have wide application and that are highly sought after, e.g., surface grinding, I say the chances are pretty good that you'll uncover something interesting. If your background is highly specific (nuclear waste technician), don't bother.

There is a cost in time and money with this approach. You'll pay for postage and extra resumes. You can also buy expensive mailing lists or spend hours in the library developing your own.

Notice that I'm not discouraging you, however, which is absolute heresy in my business. Mass mailing is regarded by most vocational consultants as wasted ef-

**Q** What about mass mailings? I'm willing to drop a thousand resumes in the mail to local companies if it will pay off.

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Knowing how much a middleman gets paid can help you distinguish sales types from fact. They are actually several different kinds of recruiters who are compensated in totally different ways.

**Career Building Tip:** Get a job — any job — in a related field while going to school. An amazing number of graduates with excellent academic credentials in, say, engineering, spend their summers making swirlies cones or delivering pizzas while good factory jobs can be had for the asking. Employers will always give the nod to a candidate who has demonstrated interest in the industry by actually working in it, even at the lowest level.

Plan now for the summer of 1996. Finance majors: sweep the floor at the bank. Aspiring architects: Clean up at job sites. Future veterinarians: Grab a shovel.

**Q** Do I really need to give two weeks' notice before leaving? I'd like to just walk out!

**A** Giving notice is the right thing to do — and the smart thing. The most typical negative comment I hear when doing reference checks is: "She left us with no backup and no warning. We thought it was unprofessional."

sell quite as hard and seem to screen a little more thoroughly for their client companies. They can also be slower moving and generally won't send you out on additional interviews if the outcome of one is still pending.

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Many people mistakenly believe that the recruiter is working for them. The recruiter is always working for himself and the client company paying the fee. Recruiters don't find jobs for people. They find people for jobs. There's a big difference.

**Career Building Tip:** Get a job — any job — in a related field while going to school. An amazing number of graduates with excellent academic credentials in, say, engineering, spend their summers making swirlies cones or delivering pizzas while good factory jobs can be had for the asking. Employers will always give the nod to a candidate who has demonstrated interest in the industry by actually working in it, even at the lowest level.

Plan now for the summer of 1996. Finance majors: sweep the floor at the bank. Aspiring architects: Clean up at job sites. Future veterinarians: Grab a shovel.

**Q** Do I really need to give two weeks' notice before leaving? I'd like to just walk out!

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