CASE OF THE QUARTER
CASE # 4
THE RECENTLY DIVORCED WITH A BAD IDEA

GOAL

Before divorce the goal of the individual was to see his ex-wife end up with as little as possible. After the divorce his goals were for him to do okay with his half!

FACTS

Part of the client's assets before the divorce was a $300,000 face amount life insurance policy. He told the agent he was getting a divorce and wanted to know how to protect his assets. The agent sold him on buying a $1,000,000 face amount policy by using the $20,000 of cash values in his $300,000 policy. The first year Surrender Value would be virtually zero and thus the ex-wife would get 50% of this nothing. The client made the move and it was now one year later. He now discovers that he does not have $20,000 a year to spend on premiums and that all of the $20,000 that he thought he had "hidden" would now not be the ex-wives but would also not be his as the insurance company would keep it all, with the exception of about $4,000! He had paid $50,000 in premiums over the years for the original $300,000 policy and the new $1,000,000 policy and he couldn't even take a tax write off - all that was left was $4,000!

SOLUTIONS

1. The client visited with the current agent and was told all they could do was surrender the policy. He'd get his $4,000 and no tax write off. His CPA confirmed this.
2. He then called us and we suggested the following:
   - Why not move the $4,000 to a deferred annuity using the same section of the internal revenue code that the agent had used when he changed from a $300,000 policy to a $1,000,000 policy.
   - Section 1035 of the Code states that an individual can move funds tax free from one existing life insurance policy to a new life insurance policy, from an annuity policy to a new annuity policy or from a life insurance policy to a new annuity. It is not permitted to move from an annuity to a life insurance policy.
   - By using 1035 to move the $4,000 to an annuity, we accomplished one of two things:
     - ✓ He can let his annuity sit until it is worth $50,000 and then cash it out and pay no tax. His basis was $50,000 so no tax would be due.
     - ✓ Or he can wait a few years and take an ordinary loss. An annuity can take a loss while a life insurance policy cannot. It just cannot be a "step transaction".

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