Income Tax Planning

SALES KIT

In this kit:

Tax facts at-a-glance | Producer & consumer guides | 1040 overlay guide

Brighthouse FINANCIAL®
Build for what's ahead™

Using Your Client's Tax Returns to Help Grow Your Business

Brighthouse Financial Advanced Sales Center

A great source of planning opportunities are the first two pages of your client's 1040 tax return and its associated schedules and forms. Here are some potential planning opportunities you can uncover with just a quick review of your client's 1040 tax form from this year or last year.

Review the planning opportunities inside. Get familiar with "What to Look For" and "What to Say." Your knowledge of the 1040 form may help ignite an interest in working with you. The goal is not just to achieve a simple product sale. The goal is to show your client how much you know and how much you may be able to help them if they work more closely with you.

Planning Opportunity

College Savings

Form(s)	Line(s)	What to Look For	What to Say
1040	Page 1 Sections 1-4	Dependents	"Have you made any plans to fund your children's education?"

Planning Opportunity

IRAs

Form(s)	Line(s)	What to Look For	What to Say
1040	4a	IRAs, Pensions, and Annuities	"Are you happy with your current IRA provider? Would you like to see how you can help generate guaranteed lifetime income from your IRA assets?"[1]

Planning Opportunity

Life Insurance

Form(s)	Line(s)	What to Look For	What to Say
1040	Page 1	Spouse and/or Dependents	"Are you certain you have enough life insurance to cover what your dependents may need in case something happened to you? What could happen if you die before you've fully funded your children's education?"

[1] Guarantees apply to certain insurance and annuity products (not securities, variable, or investment advisory products), including optional benefits, and are subject to product terms, exclusions, limitations, and the insurer's claims-paying ability and financial strength.

Planning Opportunity

Deferred Annuities (Non-Qualified)

Form(s)	Line(s)	What to Look For	What to Say
1040	1	Wages, Salaries, Tips, etc. (above $100,000)	"If you are maxing out your 401(k) at work, let me show you some ways to make additional investments in a tax-efficient manner – without many of the restrictions of a qualified plan."
1040	2a, 2b	Interest Income	"Are you spending all of this interest income? If not, perhaps we can invest it in a way that may save you taxes and make you more money. What is the real purpose of the money that is causing all of this taxable income? If it's long-term growth, there may be smarter ways to invest it. If your goal is to reduce taxes, let me show you some ways to possibly reduce your taxes and give you more growth potential."
1040	3a, 3b	Dividend Income	"Are you spending all of this dividend income? If not, maybe we can invest it in a way that may save you taxes and grow your money faster."
Schedule 1	13	Capital Gain or (Loss)	"There may be an opportunity to reduce your capital gains taxes by shifting some of your assets into a tax-deferred product."
Schedule 1	32	IRA Deduction	"Let me show you how to potentially reduce the taxes on your Social Security income. Did you know that if we shift some of your unspent taxable income into a tax-deferred program, we may be able to reduce the taxes on your Social Security income?" (This can also lead to conversations about claiming strategies.)

Planning Opportunity

Bonds or Bond Funds

Form(s)	Line(s)	What to Look For	What to Say
1040	2a, 2b	Interest Income	"Perhaps I can show you how to increase the yield or credit quality of your bond portfolio."

Planning Opportunity

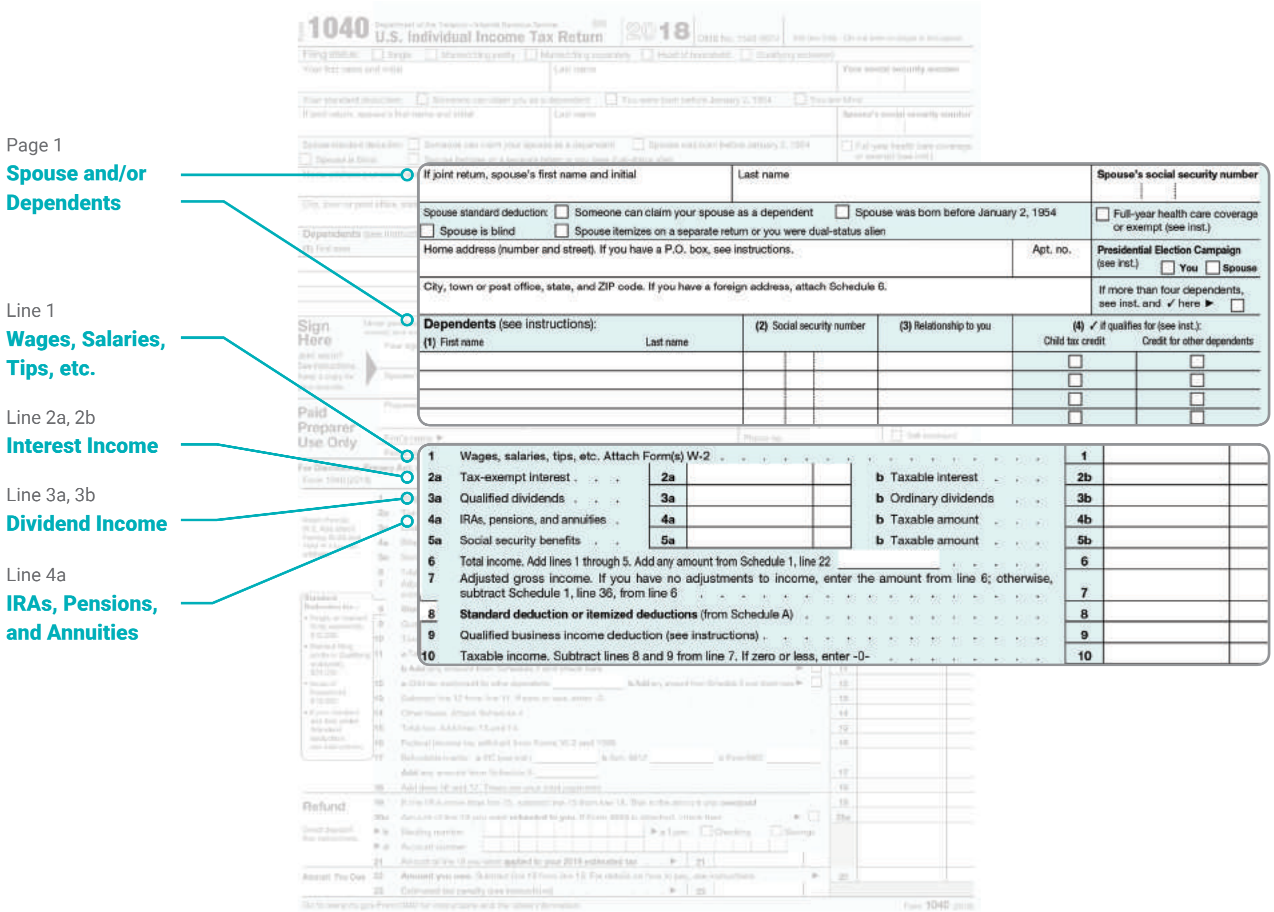
Stocks

Form(s)	Line(s)	What to Look For	What to Say
Schedule 1 Schedule D Schedule D	13 Part I Part II	Capital Gain or (Loss) Short-Term Gains & Losses Long-Term Gains & Losses	"When was the last time you rebalanced your portfolio? Is there one person who oversees your entire portfolio?"

Planning Opportunity

Qualified Plans, SEPs, and SIMPLE IRAs

Form(s)	Line(s)	What to Look For	What to Say
Schedule 1	27	Self-Employment Tax	"Do you have any qualified plans that you contribute to annually? If "no," then: "Would you like to learn more about how a qualified plan may reduce your current taxes and give you growth potential with long-term tax advantages? Can I show you how easy it is to set up a SEP or SIMPLE IRA qualified plan and the tax benefits of doing it today?"
Schedule C	Part II, Line 19	Pension and Profit-Sharing Plans	"Are you satisfied with the performance of your (Qualified, SIMPLE, SEP, etc.) plan? Would you like to consider other alternatives that may be more suitable to help meet the needs of your business?"
Schedule A	11	Gifts to Charity (Qualified Charitable Distributions)	"Are you making gifts to any charities? If you are older than age 70½, are you making those gifts directly from your IRAs or are you making those gifts with cash or checks?"



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Any discussion of taxes is for general informational purposes only, does not purport to be complete or cover every situation, and should not be construed as legal, tax, or accounting advice. Clients should confer with their qualified legal, tax, and accounting advisors as appropriate.

Withdrawals of taxable amounts are subject to ordinary income tax. Withdrawals made before age 59½ may also be subject to a 10% federal income tax penalty. Distributions of taxable amounts from a non-qualified annuity may also be subject to the 3.8% Unearned Income Medicare Contribution tax that is generally imposed on interest, dividends, and annuity income if the modified adjusted gross income exceeds the applicable threshold amount. Withdrawals will reduce the death benefit and account value. Withdrawals may be subject to withdrawal charges.

Annuities and life insurance are issued by Brighthouse Life Insurance Company, Charlotte, NC 28277 and, in New York only, by Brighthouse Life Insurance Company of NY, New York, NY 10017 ("Brighthouse Financial").

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Lincoln Financial Group®

Tax impact: identify opportunities

How taxes affect your clients' retirement plans and how you can help protect their wealth

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The Form 1040 tax guide can help you:

Find areas where your clients could benefit from more tax-efficient strategies	Gain a more comprehensive picture of each client's financial situation	Provide value-added service to establish a stronger relationship with your clients

Underneath your personal information:

You see a new question asking "At any time during 2020, did you receive, sell, send, exchange, or otherwise acquire any financial interest in any virtual currency?" The IRS now treats Bitcoin (and similar currencies) as investment property and should be reported just like any other investment. This is normally detailed on Form 8949. The conventional wisdom is that the IRS is preparing to crack down on people who are trading cryptocurrency but not reporting any income from it.

Lines 2a and 2b

Taxable and tax-exempt interest

Clients paying taxes on this income have options if they don't want or need it at the present time.

Lines 3b and 7

Dividends and capital gains from taxable mutual funds

Qualified plans, IRAs and annuities provide tax-deferred growth potential on all interest and dividends, enabling your clients' money to grow faster than it would with a taxable product.

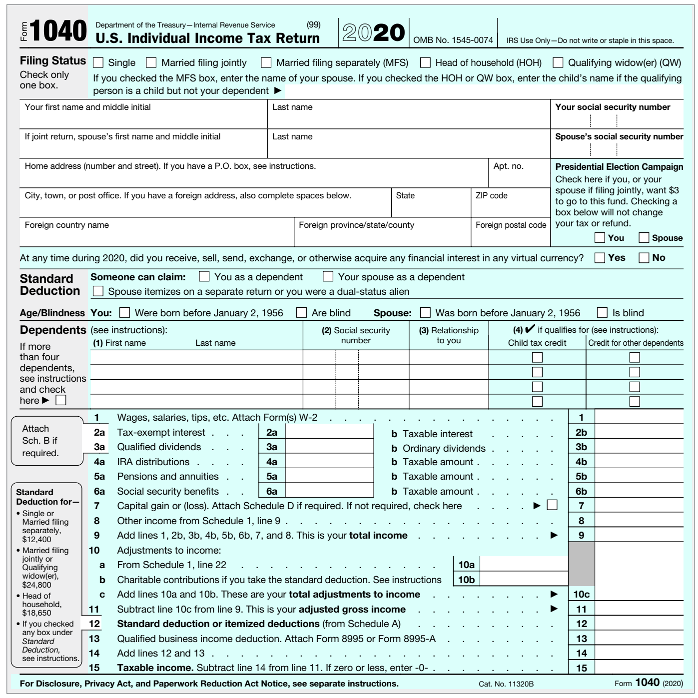
Lines 4b and 5b

RMDs, pensions and other income

RMDs (for both IRA/401(k) owners and IRA/401(k) beneficiaries) were waived in TY 2020.

An amount here may also indicate the client took a Coronavirus-Related Distribution from a qualified account. The recognition of tax of CRDs can be spread evenly over TYs 2020, 2021, and 2022.

If a client took a CRD and is under age 59.5, they should review the 1099R issued by the administrator/custodian to determine if the distribution was coded as exempt or not exempt from the 10% additional tax. The waiver of the 10% penalty under the CARES Act may need to be notated on Form 5329.



Form 1040 Department of the Treasury—Internal Revenue Service (99)
U.S. Individual Income Tax Return 2020 OMB No. 1545-0074 IRS Use Only—Do not write or staple in this space.

Filing Status Check only one box. ☐ Single ☐ Married filing jointly ☐ Married filing separately (MFS) ☐ Head of household (HOH) ☐ Qualifying widow(er) (QW)
If you checked the MFS box, enter the name of your spouse. If you checked the HOH or QW box, enter the child's name if the qualifying person is a child but not your dependent ▶

Your first name and middle initial | Last name | Your social security number
If joint return, spouse's first name and middle initial | Last name | Spouse's social security number
Home address (number and street). If you have a P.O. box, see instructions. | Apt. no.
City, town, or post office. If you have a foreign address, also complete spaces below. | State | ZIP code
Foreign country name | Foreign province/state/county | Foreign postal code
Presidential Election Campaign Check here if you, or your spouse if filing jointly, want $3 to go to this fund. Checking a box below will not change your tax or refund. ☐ You ☐ Spouse

At any time during 2020, did you receive, sell, send, exchange, or otherwise acquire any financial interest in any virtual currency? ☐ Yes ☐ No

Standard Deduction Someone can claim: ☐ You as a dependent ☐ Your spouse as a dependent
☐ Spouse itemizes on a separate return or you were a dual-status alien

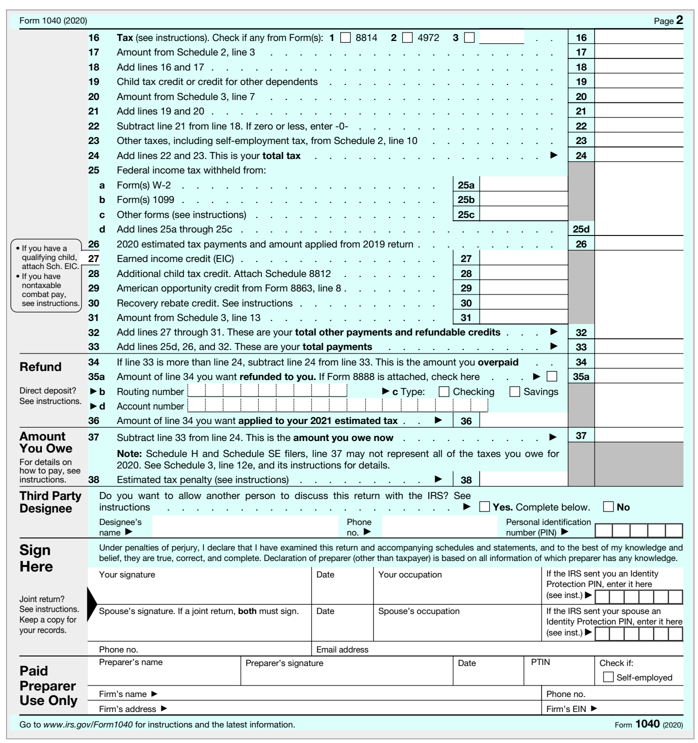
Age/Blindness You: ☐ Were born before January 2, 1956 ☐ Are blind Spouse: ☐ Was born before January 2, 1956 ☐ Is blind

Dependents (see instructions): (1) First name Last name (2) Social security number (3) Relationship to you (4) ✔ if qualifies for (see instructions): Child tax credit Credit for other dependents
If more than four dependents, see instructions and check here ▶ ☐

1	Wages, salaries, tips, etc. Attach Form(s) W-2	1
2a	Tax-exempt interest 2a	b Taxable interest 2b
3a	Qualified dividends 3a	b Ordinary dividends 3b
4a	IRA distributions 4a	b Taxable amount 4b
5a	Pensions and annuities 5a	b Taxable amount 5b
6a	Social security benefits 6a	b Taxable amount 6b
7	Capital gain or (loss). Attach Schedule D if required. If not required, check here ▶ ☐	7
8	Other income from Schedule 1, line 9	8
9	Add lines 1, 2b, 3b, 4b, 5b, 6b, 7, and 8. This is your **total income** ▶	9
10	Adjustments to income:	
a	From Schedule 1, line 22 10a	
b	Charitable contributions if you take the standard deduction. See instructions 10b	
c	Add lines 10a and 10b. These are your **total adjustments to income** ▶	10c
11	Subtract line 10c from line 9. This is your **adjusted gross income** ▶	11
12	**Standard deduction or itemized deductions** (from Schedule A)	12
13	Qualified business income deduction. Attach Form 8995 or Form 8995-A	13
14	Add lines 12 and 13	14
15	**Taxable income.** Subtract line 14 from line 11. If zero or less, enter -0-	15

Attach Sch. B if required.
Standard Deduction for— • Single or Married filing separately, $12,400 • Married filing jointly or Qualifying widow(er), $24,800 • Head of household, $18,650 • If you checked any box under Standard Deduction, see instructions.

For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see separate instructions. Cat. No. 11320B Form 1040 (2020)



Form 1040 (2020) Page 2

16	Tax (see instructions). Check if any from Form(s): 1 ☐ 8814 2 ☐ 4972 3 ☐	16
17	Amount from Schedule 2, line 3	17
18	Add lines 16 and 17	18
19	Child tax credit or credit for other dependents	19
20	Amount from Schedule 3, line 7	20
21	Add lines 19 and 20	21
22	Subtract line 21 from line 18. If zero or less, enter -0-	22
23	Other taxes, including self-employment tax, from Schedule 2, line 10	23
24	Add lines 22 and 23. This is your **total tax** ▶	24
25	Federal income tax withheld from:	
a	Form(s) W-2 25a	
b	Form(s) 1099 25b	
c	Other forms (see instructions) 25c	
d	Add lines 25a through 25c	25d
26	2020 estimated tax payments and amount applied from 2019 return	26
27	Earned income credit (EIC) 27	
28	Additional child tax credit. Attach Schedule 8812 28	
29	American opportunity credit from Form 8863, line 8 29	
30	Recovery rebate credit. See instructions 30	
31	Amount from Schedule 3, line 13 31	
32	Add lines 27 through 31. These are your **total other payments and refundable credits** ▶	32
33	Add lines 25d, 26, and 32. These are your **total payments** ▶	33
34	If line 33 is more than line 24, subtract line 24 from line 33. This is the amount you **overpaid**	34
35a	Amount of line 34 you want **refunded to you.** If Form 8888 is attached, check here ▶ ☐	35a
▶ b	Routing number ▶ c Type: ☐ Checking ☐ Savings	
▶ d	Account number	
36	Amount of line 34 you want **applied to your 2021 estimated tax** ▶ 36	
37	Subtract line 33 from line 24. This is the **amount you owe now** ▶	37
	Note: Schedule H and Schedule SE filers, line 37 may not represent all of the taxes you owe for 2020. See Schedule 3, line 12e, and its instructions for details.	
38	Estimated tax penalty (see instructions) ▶ 38	

• If you have a qualifying child, attach Sch. EIC. • If you have nontaxable combat pay, see instructions.

Refund — Direct deposit? See instructions.

Amount You Owe — For details on how to pay, see instructions.

Third Party Designee — Do you want to allow another person to discuss this return with the IRS? See instructions ▶ ☐ Yes. Complete below. ☐ No
Designee's name ▶ Phone no. ▶ Personal identification number (PIN) ▶

Sign Here — Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.
Your signature | Date | Your occupation | If the IRS sent you an Identity Protection PIN, enter it here (see inst.) ▶
Joint return? See instructions. Keep a copy for your records.
Spouse's signature. If a joint return, **both** must sign. | Date | Spouse's occupation | If the IRS sent your spouse an Identity Protection PIN, enter it here (see inst.) ▶
Phone no. | Email address

Paid Preparer Use Only — Preparer's name | Preparer's signature | Date | PTIN | Check if: ☐ Self-employed
Firm's name ▶ | Phone no.
Firm's address ▶ | Firm's EIN ▶

Go to *www.irs.gov/Form1040* for instructions and the latest information. Form 1040 (2020)

*The SECURE Act made several changes to IRAs and employer-sponsored retirement plans to make it easier for individuals to contribute. Talk with your clients to ensure they are taking full advantage of the new rules.

Work with your client's accountant and attorney to optimize tax, estate and income planning strategies.

Line 6b

Reduce taxes on Social Security income

Annuity and variable life insurance earnings not withdrawn are not part of modified adjusted gross income, which is used to determine how much Social Security benefits are taxed. This is also true for the tax-excludable portion of an annuitized income stream.

Line 11

IRA contributions

Clients with earned income may make a deductible contribution to an IRA, which can lower their adjusted gross income (AGI) and overall tax liability. With the passage of the SECURE ACT, clients have additional options to make a deductible IRA contribution in 2020. Owning an annuity inside an IRA offers access to guarantees as well as professional management, ease of diversification, and asset allocation.

Line 12

Beneficiaries: qualified accounts and nonqualified annuities

If your client is the beneficiary of an IRA, employer-sponsored retirement plan, pension or nonqualified annuity, cashing it out as a lump sum might cause a large (and possibly unnecessary) tax liability. Make a point of discussing other more tax-efficient options with your clients.

Line 13

Qualified Business Income Deduction

People taking the standard deduction (i.e., not itemizing) could take an above-the-line deduction of $300 in 2020, but as of right now, this deduction is just for TY 2020, and does not extend to 2021 (though this may change).

Line 15

Employer-sponsored retirement plans

A company-sponsored retirement plan can help reduce an individual's taxable wages and has higher contribution limits than an IRA, resulting in greater retirement savings. Refer to SECURE ACT on page 2.*

IRAs and employer-sponsored retirement plans*

Talk with your clients about the new rules and whether they should have a review of the beneficiary designations on their existing qualified accounts or nonqualified annuities.

Line 29

College savings

A Coverdell Education Savings Account (CESA) and 529 college savings plan (CSP) can provide tax-free treatment of growth and other tax advantages.

Line 35a

Investing a tax refund

Your clients can contribute all or a portion of their tax refund to a traditional IRA or Roth IRA, or purchase an annuity or life insurance policy.

Lines 25 a/b/c/d (new for TY 2020)

Federal income tax withholding amounts (previously reported as a single lump amount on a single Line 25) are now broken out into three categories (25a = W2 withholding; 25b = 1099 withholding; 25c = other withholding), with the total listed on 25d. Like Bitcoin, this change suggests that the IRS is going to look closer at tax withholding for self-employed individuals and gig workers (e.g., Uber or DoorDash drivers).

Line 30 (new for TY 2020)

The Recovery Rebate Credit is the source of the $1,200 "Coronavirus Checks" that were issued last spring. If you were due a check and for some reason did not receive it (or didn't get as much as you should have), this is where you can claim your shortfall (as a credit against your 2020 taxes).

Line 37 (new for TY 2020)

The "NOTE" subsection is new for tax year 2020 — another form of Coronavirus relief was a deferral of OASDI taxed due on your wages (6.2% paid by you; another 6.2% paid by your employer). These taxes were not waived, just deferred, and they must be paid back. Those impacted should refer to Schedule 3 for guidance as instructed.

Tips for talking taxes with your clients

Note that Schedules A and C may offer additional tax advantages for small-business owners and sole proprietors.

Consider how evolving tax regulations may impact your clients' estate plans and their ability to cover healthcare costs in the future.

Lincoln offers tax-efficient products and strategies that may help clients prepare for the impact of taxes.

There is no additional tax benefit for annuity contracts purchased in an IRA or other tax-qualified plan, since these are already afforded tax-deferred status. Thus, an annuity should only be purchased in an IRA or qualified plan if you value some other features of the annuity and are willing to incur any additional costs associated with the annuity to receive such benefits.

The value of partnering with Lincoln

For more than 115 years, The Lincoln National Life Insurance Company has provided guidance and solutions that empower Americans to take charge of their financial lives with confidence and optimism. We are committed to helping your clients plan for retirement, prepare for the unexpected, and protect their wealth.

Don't miss this opportunity to engage your clients on their tax concerns and help them protect their wealth.

For information and guidance on the solutions mentioned here, contact your Lincoln representative.

Not a deposit
Not FDIC-insured
Not insured by any federal government agency
Not guaranteed by any bank or savings association
May go down in value

Contact your Lincoln representative or call 855-831-7067 for more information.

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Order code: LFD-1040-BRC001

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Form **1040** Department of the Treasury—Internal Revenue Service (99)
U.S. Individual Income Tax Return **2019** OMB No. 1545-0074 IRS Use Only—Do not write or staple in this space.

Filing Status Check only one box.

☐ Single ☐ Married filing jointly ☐ Married filing separately (MFS) ☐ Head of household (HOH) ☐ Qualifying widow(er) (QW)

If you checked the MFS box, enter the name of spouse. If you checked the HOH or QW box, enter the child's name if the qualifying person is a child but not your dependent. ▶

Your first name and middle initial	Last name	Your social security number
If joint return, spouse's first name and middle initial	Last name	Spouse's social security number

Home address (number and street). If you have a P.O. box, see instructions.	Apt. no.	**Presidential Election Campaign** Check here if you, or your spouse if filing jointly, want $3 to go to this fund. Checking a box below will not change your tax or refund. ☐ You ☐ Spouse
City, town or post office, state, and ZIP code. If you have a foreign address, also complete spaces below (see instructions).		

Foreign country name	Foreign province/state/county	Foreign postal code	If more than four dependents, see instructions and ✓ here ▶ ☐

s blind

es for (see instructions): Credit for other dependents

1 Wages, salaries, tips, etc. Attach Form(s) W-2 1

2a Tax-exempt interest . . . . 2a b Taxable interest. Attach Sch. B if required 2b

inary dividends. Attach Sch. B if required 3b

able amount 4b

able amount 4d

able amount 5b

6

7a

7b

8 Add lines 1, 2b, 3b, 4b, 4d, 5b, 6, and 7a. This is your total income 8a

8b

9

10

11a

11b

Standard Deduction • Single or filing sep $12,200 • Married f jointly or widow(er $24,400 • Head of

For Cat. No. 11320B Form **1040** (2019)

Lines 2a and 2b: Consider ways to defer taxes on some of your money. When comparing taxable vs. tax-advantaged returns, be sure to take your marginal tax rate (the rate on the last dollar of earned income) into account. A higher marginal tax rate means more taxes, making tax-advantaged investing even more important.

Lines 3b and 6: Reduce the taxes you pay on dividends and capital gains from taxable mutual funds by moving to tax-efficient funds or holding retirement savings inside a qualified plan, IRA or annuity.

Lines 4b and 4d: The income under 4b could be from an RMD, and the income under 4d may be from a pension. Your financial professional can verify the sources and help you decide what to do with this income if you don't need it now.

Line 5b: Are you paying taxes on Social Security benefits? You may be able to reposition some of your assets to help reduce the tax liability on your Social Security income.

Line 8b: Depending on your age, income, and tax filing status, you may be able to take a full or partial deduction for contributions up to $6,000 to an IRA until April 15, 2020. If you're over age 50, you can make an additional "catch-up" contribution of $1,000.

Line 9: If you're the beneficiary of an IRA, cashing it out may create a significant tax liability. If you're the surviving spouse, rolling over the IRA to your name may be more tax-efficient. Also, IRA beneficiaries may be able to take an itemized deduction equal to the estate tax paid on the IRA.

Line 11b: Participating in a company-sponsored retirement plan may help reduce your taxable income.

2872971

12a	**Tax** (see inst.) Check if any from Form(s): 1 ☐ 8814 2 ☐ 4972 3 ☐	12a		
b	Add Schedule 2, line 3, and line 12a and enter the total ▶		12b	
13a	Child tax credit or credit for other dependents	13a		
b	Add Schedule 3, line 7, and line 13a and enter the total ▶		13b	
			14	
			15	
	▶		16	
			17	
		18a		
b	Additional child tax credit. Attach Schedule 8812	18b		
c	American opportunity credit from Form 8863, line 8	18c		
d	Schedule 3, line 14	18d		
e	Add lines 18a through 18d. These are your **total other payments and refundable credits** ▶		18e	
	▶		19	
			20	
	▶ ☐		21a	
	☐ Savings			
22	Amount of line 20 you want **applied to your 2020 estimated tax** ▶	22		
23	**Amount you owe.** Subtract line 19 from line 16. For details on how to pay, see instructions ▶		23	
24	Estimated tax penalty (see instructions) ▶	24		

• If you have nontaxable combat pay, see instructions.

Refund

Direct depos... See instructi...

Amount You Owe

Line 18c: You can save for your children's education and receive potential tax benefits. A Coverdell Education Savings Account and a 529 college savings plan both provide the tax-free treatment of growth in addition to other tax advantages.

Line 20: Consult a tax professional to determine the correct amount to withhold based on your total projected income, number of dependents, and other qualifying deductions.

Third Party Designee

(Other than paid preparer)

Do you want to allow another person (other than your paid preparer) to discuss this return with the IRS? See instructions. ☐ **Yes.** Complete below. ☐ **No**

Designee's name ▶

Line 24: Prevent a possible tax penalty by recalculating your W-4 or estimated tax payment.

Sign Here

Under penalties of perjury, I declare that I have ... dge and belief, they are true, correct, and complete. Declaration of preparer (o...

Joint return? See instructions. Keep a copy for your records.

Your signature			...sent you an Identity Protection PIN, enter it here (see inst.)
Spouse's signature. If a joint return, **both** must sign.	Date	Spouse's occupation	If the IRS sent your spouse an Identity Protection PIN, enter it here (see inst.)
Phone no.	Email address		

Paid Preparer Use Only

Preparer's name	Preparer's signature	Date	PTIN	Check if: ☐ 3rd Party Designee ☐ Self-employed
Firm's name ▶		Phone no.		
Firm's address ▶			Firm's EIN ▶	

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PACIFIC LIFE

UNDERSTANDING TAXES

Answers to Seven Commonly Asked Questions

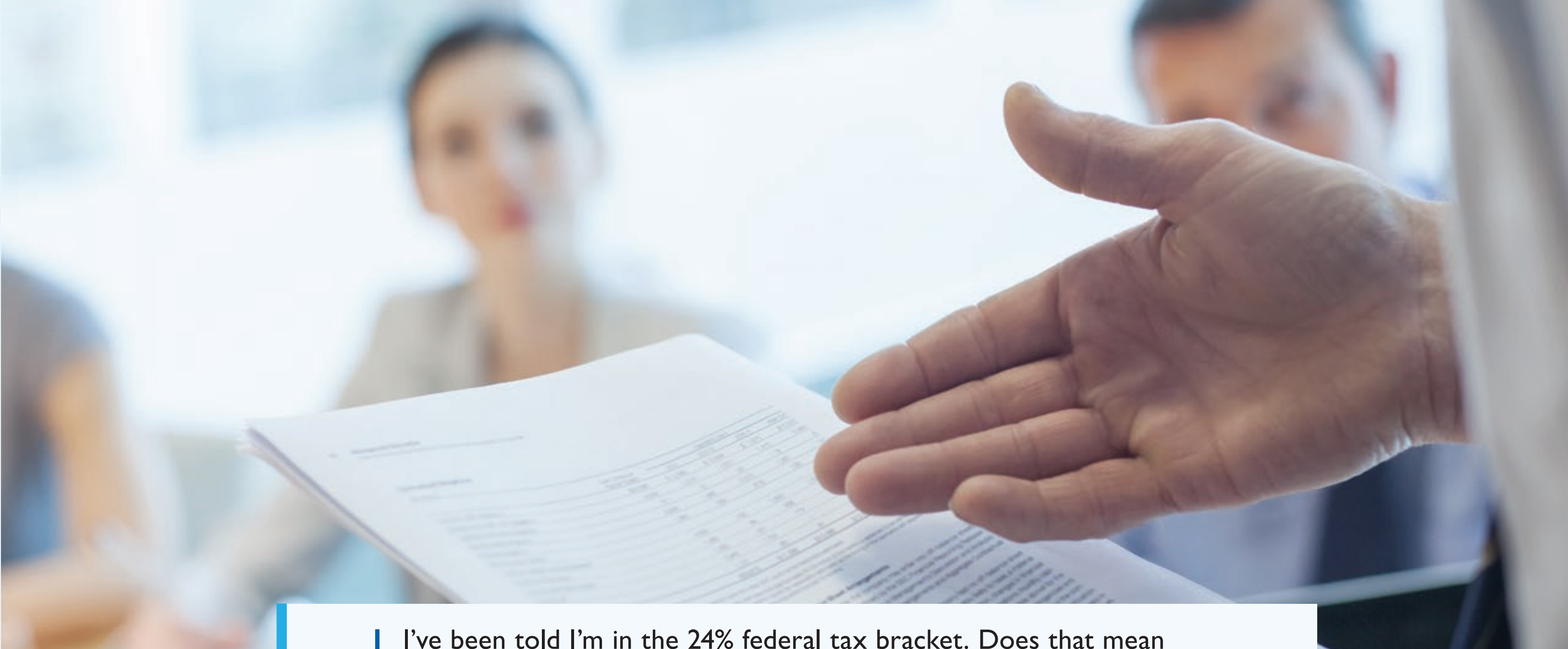
Planning Considerations for
Nonqualified Annuities and Other Investments

VAC0773-0620

INCREASED TAX KNOWLEDGE MAY MEAN MORE MONEY IN YOUR POCKET

Often, a single, well-thought-out tax strategy can put you in a position to keep significantly more of your investment earnings. That's why it's important to know the tax implications of your investment decisions.

On the following pages are seven common questions and answers about taxes.



1 I've been told I'm in the 24% federal tax bracket. Does that mean all my income is taxed at 24%?

2 My tax professional uses the terms *marginal income-tax rate* and *effective income-tax rate*. What's the difference?

3 If I'm a high-income taxpayer, do I need to pay the Net Investment Income Tax?

4 Are all capital gains taxed at the same rate?

5 Are all distributions from my deferred annuity taxed equally?

6 If I take annuity distributions before age 59½, will I have to pay additional taxes?

7 What are the tax implications if my surviving spouse continues my annuity contract?

Your financial professional and/or tax advisor may address additional questions you have, as well as discuss the kind of tax strategies that may be appropriate for you.

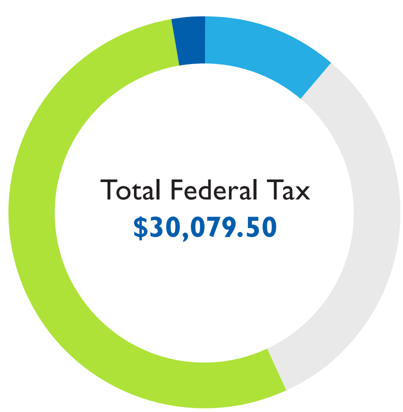
1 I've been told I'm in the 24% federal tax bracket. Does that mean all my income is taxed at 24%?

There is no single rate at which all your income is taxed. Your tax bracket reflects the highest rate at which you'll pay federal income taxes (also referred to as your marginal income-tax rate). However, some of your income will be taxed at lower rates. Here's how it works.

Hypothetical Example: Single Taxpayer with $150,000 of Taxable Income

Taxable Income (2020 Federal Tax Bracket)	**Is Taxed At** (Marginal Income Tax Rate)	**Calculation**	**Resulting in Federal Taxes of**
$0 to $9,875	10%	$9,875 x 0.10	$987.50
> $9,875 to $40,125	12%	($40,125 – $9,875) x 0.12	$3,630
> $40,125 to $85,525	22%	($85,525 – $40,125) x 0.22	$9,988
> $85,525 to $163,300	24%	($150,000 – $85,525) x 0.24	$15,474

Your situation may be different. Higher tax brackets, rates, and filing statuses may apply.

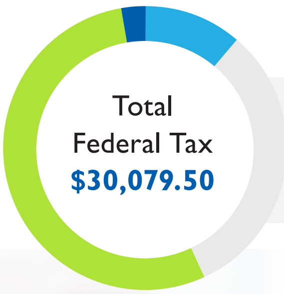


Planning Consideration—**Be aware of the amount of your taxable income and federal tax bracket thresholds.**

Consider deferring some income to keep yourself out of the next highest tax bracket.

2 My tax professional uses the terms *marginal income-tax rate* and *effective income-tax* rate. What's the difference?

The marginal income tax rate is simply the highest rate at which your last dollar earned will be taxed. On the other hand, the effective income-tax rate is the actual amount of taxes you paid on all the income you earned. Using the results from the example on the previous page, please see the explanation below.



Total Federal Tax **$30,079.50** ÷ Taxable Income **$150,000** = Effective Income-Tax Rate **20.05%**

Marginal Income Tax Rate **24%**

Planning Consideration—**Use your effective income-tax rate when doing tax planning.**

Consider the effective income-tax rate when doing tax-planning exercises. The result will be closer to your actual taxes paid than using your tax bracket or marginal income-tax rate.

3 If I'm a high-income taxpayer, do I need to pay the Net Investment Income Tax?

The Net Investment Income Tax (NIIT) became effective January 1, 2013, to help fund the Affordable Care Act. This additional 3.8% federal tax can impact taxpayers who exceed the modified adjusted gross income (MAGI)[1] thresholds of $200,000 for single filers, and $250,000 for married couples filing jointly. The 3.8% NIIT applies to the lesser of net investment income or the excess of MAGI over the threshold amount. However, taxpayers may be able to avoid the NIIT by carefully managing their MAGI levels and net investment income levels.

Planning Considerations—**Consider strategies that lower MAGI and net investment income.**

- **Tax-deferred annuities:** If you do not need income now and would like for some of your assets to continue growing tax-deferred, a nonqualified annuity allows you to defer the growth. Because no income is being paid out, the deferred growth will not be subject to NIIT. However, if you start taking distributions, the growth will increase your MAGI and may be subject to NIIT.
- **Charitable giving:** Gifts made to charities may lower your overall MAGI.
- **Roth IRAs:** Qualified distributions from Roth IRAs are not subject to income tax, so it will not increase your MAGI.
- **Municipal bonds:** Income from these bonds is generally not included in MAGI.
- **Your workplace retirement plan:** Distributions from most 401(k)s, 403(b)s, and other employer retirement plans are not considered net investment income, but will increase your MAGI.

[1]MAGI, for purposes of the NIIT, is generally defined as adjusted gross income (AGI) for regular income-tax purposes increased by the foreign earned-income exclusion and adjusted for certain deductions related to foreign earned income. For an individual taxpayer who does not exclude foreign earned income, the regular AGI will also be the MAGI.

4 Are all capital gains taxed at the same rate?

There are two types of capital gains:

- Short-term: Capital gains on assets held for one year or less. These are taxed at ordinary income-tax rates.
- Long-term: Capital gains on assets held for more than one year. These are taxed at capital-gains rates, which are more favorable than ordinary income-tax rates.

For 2020, long-term capital gains are applied to maximum taxable income levels for a Single filer as follows:

If Your Taxable Income Is	Your Long-Term Capital Gains Tax Rate Is
Up to $40,000	0%
$40,000 to $441,450	15%
Over $441,450	20%

Planning Considerations

- **Hold capital-gains-producing assets for one year or more.** Taxes on your gains will be taxed as capital gains instead of ordinary income.
- **Consider the effect of mutual funds in your capital-gains planning.** Holding mutual funds can be an effective way to diversify your holdings and benefit from professional fund management. However, the funds' managers determine when assets are bought and sold. If they are bought and sold quickly, this may result in short-term gains that are taxable to you at ordinary income-tax rates.

5 Are all distributions from my deferred annuity taxed equally?

In a nonqualified deferred annuity (that is neither an IRA nor part of an employer-sponsored retirement plan), there are two types of distributions you can elect, resulting in different tax treatments: withdrawals or annuitization.

In the following hypothetical example, let's compare the two. Let's say Bob, age 62, decides to retire and use his deferred annuity for retirement income. The example shows what his first five years would look like if he chose withdrawals versus annuitization.

Withdrawals

If taking withdrawals, all gains, which are taxable, will be withdrawn first. Basis,[1] which is after-tax dollars invested in a deferred annuity, is not taxable and is withdrawn last.

- Annuity contract value when income begins: $200,000.
- Annuity contract basis: $187,000.
- Annuity contract gain: $13,000.
- For illustrative purposes, assumes no yearly gain or rate of return, and annual withdrawals are made at the end of each year.
- Withdrawals end when the contract value is depleted.

For annuities, keep in mind that a withdrawal charge also may apply. Withdrawals will reduce the contract value and the value of the death benefits, and also may reduce the value of any optional benefits.

	Year 1	Year 2	Year 3	Year 4	Year 5
Withdrawal Amount	$5,000	$5,000	$5,000	$5,000	$5,000
Taxable Portion on Gain	$5,000	$5,000	$3,000	$0	$0
Tax-Free Return of Basis	$0	$0	$2,000	$5,000	$5,000
Remaining Contract Value	$195,000	$190,000	$185,000	$180,000	$175,000
Remaining Contract Basis	$187,000	$187,000	$185,000	$180,000	$175,000

[1]Basis: Also referred to as principal. Distributions of principal are not taxable.

Annuitization

This series of guaranteed income payments is taxed on an exclusion-ratio basis, which means a portion of each payment is tax-exempt and represents a return of the initial investment rather than earnings or gains. Therefore, taxation is more evenly distributed throughout the years.

- Annuity payments may continue for your choice of:
  (1) Your entire life (as illustrated in this hypothetical example).
  (2) Your life plus the life of another person.
  (3) A fixed period, such as 5 or 10 years.
- Purchase payment amount: $200,000.
- Exclusion ratio: 76.8%.

	Year 1	Year 2	Year 3	Year 4	Year 5
Income Payment Amount	$11,327	$11,327	$11,327	$11,327	$11,327
Taxable Portion	$2,628	$2,628	$2,628	$2,628	$2,628
Tax-Free Return of Basis	$8,699	$8,699	$8,699	$8,699	$8,699

Planning Considerations

- For withdrawals after all gains have been withdrawn, your subsequent withdrawals will not be taxable. This may be a good strategy if you prefer to pay more taxes now to receive nontaxable income later.
- Annuitization spreads out taxation. It may be a good strategy if you prefer taxation that's more evenly distributed throughout your retirement years.

Note: Taxes are not the only consideration when choosing how to take income from an annuity. Consult your financial and tax professionals before deciding on the income option that's right for your personal circumstances and needs.

6 If I take annuity distributions before age 59½, will I have to pay additional taxes?

Typically, the taxable portion of a distribution from a tax-deferred annuity that is taken prior to age 59½ will be subject to an additional 10% federal tax.

However, here are some exceptions to this rule.

Death of the Owner

After the death of a deferred annuity owner, distributions to beneficiaries are not subject to the additional 10% federal tax.

Disability

If an annuity owner becomes disabled, the additional 10% federal tax on distributions may not apply. Make sure the disability meets the IRS definition and Treasury regulations.

Substantially Equal Periodic Payments (SEPPs)

Distributions taken as SEPPs are free of the additional 10% federal tax. The payments must continue to age 59½ or for five years, whichever is longer.

1035 Exchange

The IRS allows you to fully exchange one deferred annuity contract for another without tax consequences, no matter your age. To qualify:

- The owner(s) and annuitant(s) of both contracts must be the same.
- The exchange must take place directly through the insurance companies. Cashing out one contract to purchase another may be a taxable event.

You also can perform a partial 1035 exchange, which means a portion of your annuity contract is exchanged for another contract. However, be aware that if you take distributions from either contract within 180 days of the exchange, the IRS may consider the exchange "disqualified" (that is, no longer tax-free).

7 What are the tax implications if my surviving spouse continues my annuity contract?

When a deferred annuity owner dies, his or her spouse, who is a joint owner and/or sole primary beneficiary, may choose to continue the annuity contract as its new sole owner. In that case, the additional 10% federal tax may apply to distributions made before the surviving spouse reaches age 59½.

Do You Have More Tax Questions?

The questions in this brochure represent only a sample of tax issues that may affect you. Talk to your financial and/or tax advisors about your circumstances and needs. Their knowledge and experience can be invaluable in helping you decide on tax strategies that are appropriate for helping you reach your long-term financial goals.

Talk to your financial professional to learn
about investment options and their tax implications,
or visit Annuities.PacificLife.com for more information.

VAC0773-0620

Meaningful Cost of Living Adjustments for 2022

December 2021

Equitable's Advanced Markets team offers a number of ways financial professionals can access core tax rate and contribution threshold information. It's available on our logged in website within the Advanced Markets section and within the Advanced Markets Resource Center, a third-party platform, found within that section.

This eNotive provides insights on some notable increases. As it goes to publication, Congress continues to debate tax legislation. Although they have announced there are no expected changes to most income tax rates or to estate taxes, that possibility remains something to be watchful for up until the final passage of any legislation. Advanced Markets will offer other publications and notifications as there are legislative developments.

Here's a summary of key cost of living adjustments (COLA).

Personal Rate Changes

Income tax rates

There are general cost of living adjustments across all tax brackets and across each filing status.

Standard deductions

For the 2022 tax year, the standard deduction for married couples increases to $25,900; for single filers the deduction increases to $12,950.

Estate and gift changes

Estate and gift lifetime exemptions

For 2022, the amount increases to $12,060,000. Under the Tax Cut and Jobs Act, this rate is scheduled to be reduced after 2025.

Annual gift exclusion

For the first time in several years, this amount increases to $16,000 per year per donee/gift recipient.

Retirement and benefit changes

401(k) contribution limitations
Contributions for 2022 into 401(k), 403(b) and most 457(b) plans are increased to $20,500.

IRA contribution limitations
Contributions for 2022 remain the same at $6,000 ($7,000 for those age 50 or older).

These increases apply to both traditional IRA and Roth IRA contributions.

SIMPLE IRA contribution limits for 2022 have increased to $14,000, up from $13,500. Those employees who are age 50 and over are eligible to make additional catch-up contributions, limited to an additional $3,000/year.

SEP IRA contribution limits have increased to $61,000 for 2022, up from $58,000 in 2021.

Defined contribution 415(c) limitation
The “annual additions” limitation is increased to $61,000.

401(a)(17) annual compensation limit
The annual compensation limit is increased to $305,000.

Flexible Spending Accounts (FSA)
This amount increases to $2,850.

Health Savings Accounts (HSA)
This amount increases to $3,650 for individuals and $7,300 for families. Individuals over age 50 may contribute an additional $1,000.

If you have any questions, contact Advanced Markets.

EQUITABLE

Advanced Markets

2022 Fingertip Tax Guide

This Guide has been updated to reflect 2022 tax changes related to individual income taxes, transfer taxes, business taxes, retirement contribution limits and more. Please note that under the Tax Cuts and Jobs Act (TCJA) of 2017, many of the provisions that affect individual taxpayers are set to expire at the end of 2025, reverting to pre-TCJA law.

Ordinary income taxes 2022

If taxable income is[1]:

	Over	But not over	The tax is	Of the amount over
Married filing jointly	$0	$20,550	$0 + 10%	$0
	$20,550	$83,550	$2,055 + 12%	$20,550
	$83,550	$178,150	$9,615 + 22%	$83,550
	$178,150	$340,100	$30,427 + 24%	$178,150
	$340,100	$431,900	$69,295 + 32%	$340,100
	$431,900	$647,850	$98,671 + 35%	$431,900
	$647,850	—	$174,253.50 + 37%	$647,850
Single	$0	$10,275	$0 + 10%	$0
	$10,275	$41,775	$1,027.50 + 12%	$10,275
	$41,775	$89,075	$4,807.50 + 22%	$41,775
	$89,075	$170,050	$15,213.50 + 24%	$89,075
	$170,050	$215,950	$34,647.50 + 32%	$170,050
	$215,950	$539,900	$49,335.50 + 35%	$215,950
	$539,900	—	$162,718 + 37%	$539,900
Estates and trusts	$0	$2,750	$0 + 10%	$0
	$2,750	$9,850	$275 + 24%	$2,750
	$9,850	$13,450	$1,979 + 35%	$9,850
	$13,450	—	$3,239 + 37%	$13,450

2022 Capital gains tax

Capital gains rate on collectibles	28%		
Long-term capital gains rates (other than collectibles and qualified business stock)	**Single**	**Married filing jointly**	**Trusts & estates**
0%	$41,675 or below	$83,350 or below	$2,800 or below
15%	$41,676 - $459,750	$83,351 - $517,200	$2,801-$13,700
20%	Over $459,750	Over $517,200	Over $13,700

Note: Qualified Dividends are taxed the same as capital gains.

Alternative minimum tax exemption amounts

	2021	2022
Married filing jointly	$114,600	$118,100
Single	$73,600	$75,900
Trusts and estates	$25,700	$26,500

Standard deductions

	2021	2022
Married filing jointly	$25,100	$25,900
Single	$12,550	$12,950

Net investment income (NII) tax thresholds

3.8% additional tax on earned income

	Applicable on NII when taxpayer's income exceeds
Married filing jointly	$250,000
Married filing separately	$125,000
Any other filing status	$200,000

Note: Thresholds are not indexed for inflation.

Medicare tax thresholds

0.9% Additional tax on earned income

	Applicable on earned income amounts over:
Married filing jointly	$250,000
Married filing separately	$125,000
Any other filing status	$200,000

Note: Thresholds are not indexed for inflation.

Social Security benefits

Maximum annual earnings before social security benefits are reduced

	2021	2022
Before full retirement age (lose $1 for every $2 of earnings)	$18,960	$19,560
Year of full retirement age (lose $1 for every $3 of earnings)	$50,520	$51,960
After full retirement age	No limit	No limit

FICA income limits

Maximum compensation subject to FICA taxes

	2021	2021
OASDI (Old-age, survivors and disability insurance; social security maximum)	$142,800	$147,000
HI (Hospital insurance; Medicare maximum)	No limit	No limit

Qualified plans

	2021	2022
Contribution limit to qualified retirement plans (e.g., 401(k), 403(b) & 457(b) plans)[2]	$19,500	$20,500
401(k) age 50+ catch-up contribution limit	$6,500	$6,500
Maximum IRA contribution limit	$6,000	$6,000
IRA age 50+ catch-up contribution limit	$1,000	$1,000
Maximum contribution to SIMPLE plan	$13,500	$14,000
SIMPLE plan age 50+ catch-up contribution limit	$3,000	$3,000
Annual includible compensation limit	$290,000	$305,000
Limitation on annual additions to a defined contribution plan	$58,000	$61,000
Highly compensated employee compensation limit	$130,000	$135,000
Limitation on the annual benefit under a defined benefit plan	$230,000	$245,000

Roth IRA income limits for contributions

	2021	2022
Married filing jointly	$198,000 - $208,000	$204,000 - $214,000
Single Taxpayers	$125,000 - $140,000	$129,000 - $144,000

Corporations

	2022
C corporations	21% flat tax
Pass-through businesses (s corporations, partnerships) **and sole proprietors**	Tax rate of owner, but up to 20% deduction on "qualified business income" subject to threshold limits (see 199A thresholds)

Note: Deduction for pass-through businesses is subject to strict rules and testing requirements; deduction unavailable for specified service-oriented businesses where owner's income exceeds certain limits (see below)

199A thresholds

	2021	2022
Married filing jointly	$329,800 - $429,800	$340,100 - $440,100
Married filing separate	$164,925 - $214,925	$170,050 -$ 220,050
Any other filing status	$164,900 - $214,900	$170,050 - $220,050

Long-Term Care

Periodic payments received under qualified long-term care insurance contracts or under certain life insurance contracts

	2021	2022
Per diem limit	$400	$390

Deduction for Eligible Long-Term Care Premiums per IRC 213(d)(10)

	2021	2022
Age 40 or less	$450	$450
Over age 40 but not more than 50	$850	$850
Over age 50 but not more than 60	$1,690	$1,690
Over age 60 but not more than 70	$4,520	$4,510
More than 70	$5,640	$5,640

2022 Estate & gift taxes

Over	But not over	The tax is	Of the amount over
$0	$10,000	$0 + 18%	$0
$10,000	$20,000	$1,800 + 20%	$10,000
$20,000	$40,000	$3,800 + 22%	$20,000
$40,000	$60,000	$8,200 + 24%	$40,000
$60,000	$80,000	$13,000 + 26%	$60,000
$80,000	$100,000	$18,200 + 28%	$80,000
$100,000	$150,000	$23,800 + 30%	$100,000
$150,000	$250,000	$38,800 + 32%	$150,000
$250,000	$500,000	$70,800 + 34%	$250,000
$500,000	$750,000	$155,800 + 37%	$500,000
$750,000	$1,000,000	$248,300 + 39%	$750,000
$1,000,000	—	$345,800 + 40%	$1,000,000

Tax exemptions for 2022

Annual gift tax exclusion: Individual donor may gift $16,000 per donee

Gift tax exemption: $12,060,000

Estate and generation-skipping transfer tax exemption: $12,060,000

Annual gift tax exclusion for a non-citizen spouse: $164,000

Maximum gift tax rate: 40%

Estate tax rates and exemptions

Year	Top estate tax rate	Estate tax exemption	Applicable credit
2010	0%[3]/35%	$0[3]/$5,000,000	$0[3]/$1,730,800
2011	35%	$5,000,000	$1,730,800
2012	35%	$5,120,000	$1,772,800
2013	40%	$5,250,000	$2,045,800
2014	40%	$5,340,000	$2,081,800
2015	40%	$5,430,000	$2,117,800
2016	40%	$5,450,000	$2,125,800
2017	40%	$5,490,000	$2,141,800
2018	40%	$11,180,000	$4,417,800
2019	40%	$11,400,000	$4,505,800
2020	40%	$11,580,000	$4,577,800
2021	40%	$11,700,000	$4,625,800
2022	40%	$12,060,000	$4,769,800

Note: The TCJA increased the gift, estate, and GST tax exemptions to $10M (indexed for inflation), but these exemptions are scheduled to expire and revert back to $5M (indexed for inflation) after 12/31/2025. In November 2019, final regulations were issued clarifying that there will be no "clawback" of any unified credit used before 2026 when the exemption reverts to a $5 million exemption (indexed for inflation).

For additional information, please contact your local

John Hancock Representative.

1. The rates listed are for the regular income tax. Some taxpayers may be subject to the Alternative Minimum Tax (AMT) instead; every taxpayer is responsible for paying the higher of the regular income tax or the AMT.
2. The contribution limit is the same for regular and Roth 401(k) plans; a total of $20,500 can be contributed in 2022 to one or both types of 401(k) plans.
3. In 2010, decedents had the choice between full estate tax repeal but with carryover basis or exposure to estate tax with a $5M exemption and a maximum tax rate of 35%.

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Income Taxation of Life Insurance

The following information provides a general overview of the income taxation of U.S. life insurance policies as well as addresses some of the most frequently asked questions that we receive on the topic. U.S. residency and citizenship are assumed throughout this guide.

Table of Contents

LIFE-7154 5/18

1. How is life insurance defined under the Internal Revenue Code (IRC)?

As part of major legislation enacted in the 1980's – mostly notably the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) and the Deficit Reduction Act of 1984 (DEFRA) – Internal Revenue Code §7702 was created.

To qualify as life insurance under §7702, a contract must meet either the "cash value accumulation test" or the two-pronged "guideline premium and corridor test" as follows:

- The *cash value accumulation test* (CVAT) often applies to traditional permanent life insurance policies accumulating cash value and generally limits the cash value within a policy to the "net single premium" required to fund all future benefits provided under the contract.[1] The net single premium is calculated by using an assumed interest rate, mortality charges specified in the contract, and other specified charges. A CVAT contract must satisfy the test at all times and must do so by the terms of the contract.
- The *guideline premium and corridor test* (GPT) often applies to policies where accumulating cash or maintaining a variable death benefit is most important. The test is a combination of two tests—the "guideline premium" requirement and the "cash value corridor" requirement. The guideline premium requirement restricts the total premium that can be paid into the policy to a one-time premium that would fund the future benefits of the policy (taking into account an assumed interest rate and mortality charges). The cash value corridor requirement is satisfied if at all times the policy's death benefit exceeds a stated multiple of the contract's cash value.

These tests were created to ensure that sufficient mortality risk is maintained and prevent policies from being used merely for their tax-deferred cash accumulation feature. A contract that fails to meet the testing requirements of §7702 will not be considered "life insurance" and will not receive the same tax advantages that life insurance receives. (See Question 15 for information on the taxation of a policy that fails §7702 testing requirements).

In 1988 as part of the Technical and Miscellaneous Revenue Act (TAMRA) Congress enacted additional testing requirements on life insurance to once again deter the use of life insurance solely as a tax deferred cash accumulation vehicle. This new test – referred to as the "7-Pay Test" – limits the cumulative amount of premiums that can be paid into a contract in the first seven years.[2]

More specifically, a life insurance contract will fail to meet this test if:

The cumulative premiums paid into the contract during the first 7 years	>	The sum of the net level premiums that would have been paid if the contract provided for paid-up future benefits after the payment of 7 level annual premiums

Policies that fail to meet the 7-Pay Test, but otherwise meet TEFRA and DEFRA testing requirements, are considered to be Modified Endowment Contracts (MECs) and are subject to special taxation rules. The tax treatment of MECs is discussed in more detail in Question 14.

2. Is the death benefit payable upon the death of the insured subject to income taxation?

IRC §101(a)(1) provides that gross income generally does not include amounts received under a life insurance contract if such amounts are paid by reason of the death of the insured. In other words, life insurance death benefits are usually not taxable income to the beneficiary or beneficiaries of a life insurance policy. This tax-free treatment of death benefit applies to both traditional life insurance contracts and to modified endowment contracts (MECs).

Two notable exceptions exist with respect to this general rule regarding the tax-free treatment of insurance proceeds:

1. proceeds received when there has been a "transfer-for-value" as specified in §101(a)(2); and
2. proceeds received on an employer-owned contract that does not meet the requirements under §101(j)

For more information on these exceptions, please see Questions 16 and 19, respectively.

Furthermore, keep in mind that once the proceeds become payable, any interest or investment income earned on the proceeds under a settlement agreement is also taxable. For example, if a beneficiary elects to receive insurance proceeds payable in a series of installments, instead of as a lump sum, the principal portion will be tax-free, but any interest accrued will be taxable as ordinary income.

3. Are cash value increases taxable to the owner?

If a contract meets the definition of life insurance under §7702, annual increases in cash surrender value will not be subject to income taxes while the policy is in force. For as long as a policy remains in force, cash value buildup within a policy will experience indefinite tax deferral and if the policy terminates at death, any gains will generally be exempt from taxation.

See Question 23 for special rules pertaining to the taxation of life insurance owned by a C corporation.

Although the deferral of taxation on cash value growth is not specifically provided for in the tax code, this treatment is consistent with the tax treatment of other assets that are held by a taxpayer and not disposed of in any given year. For example, a taxpayer is not taxed on the appreciation of stock values year to year unless that stock is sold or otherwise disposed of.

This principle is further supported by reference to the tax treatment of life insurance policies that do not meet the statutory definition of life insurance under §7702. Under §7702(g), income on a life insurance contract that *does not* meet the definition of life insurance under §7702(a) will be treated "as ordinary income received or accrued by the policyholder during such year." The fact that the Code specifically states that life insurance contracts that do not meet the §7702 definition are taxed year-to-year on the income strongly suggests that generally a life insurance policy that does meet the §7702 requirements will receive tax-deferred growth of the cash value inside the contract.

See Question 15 for information on the taxation of a life insurance policy that does not meet the statutory requirements of §7702.

4. When are withdrawals subject to income tax?

Under the cost recovery rule of IRC §72(e), amounts received from a life insurance contract that is not classified as a MEC are first considered to be a non-taxable recovery of the owner's "investment in the contract" and only amounts received in excess over the investment in the contract are considered taxable. In layman's terms, §72(e) generally provides that life insurance is taxed on a "first in, first out" (FIFO) method, meaning that the policy owner will receive his or her investment in the contract first before receiving any gains in the policy (or being taxed on those gains).

There is an exception to the general rule that withdrawals up to investment in the contract are generally received tax-free. This exception applies to withdrawals within the first 15 years of issuance of the policy if there is also a reduction in the policy's death benefit. For policy withdrawals in such a case, income growth may be treated as coming out before investment in the contract, up to a statutory "recapture ceiling." (See Question 5.)

For life insurance contracts classified as MECs, special taxation rules apply with respect to accessing cash value during the insured's lifetime. For more information on the tax treatment of MECs, see Question 14.

PLANNING NOTE

Before taking withdrawals or reducing death benefit, it is prudent to have an in force illustration run to determine if such actions could cause an income tax event or cause the policy to fail the 7-Pay Test and cause the policy to become a MEC.

5. How is the recapture ceiling for withdrawals and surrenders calculated?

The recapture ceiling varies depending on the year of the withdrawal/surrender within the applicable 15 year period.

POLICY TESTING METHOD (SEE QUESTION 1)	RECAPTURE CEILING FOR YEARS 1-5	RECAPTURE CEILING FOR YEARS 6-15[3]
CASH VALUE ACCUMULATION TEST (CVAT)	Excess of (i) the cash surrender value of the contract immediately before reduction in benefits over (ii) the net single premium immediately after the reduction[4]	Excess of (i) the cash surrender value immediately before reduction in benefits over (ii) the maximum cash value permitted under the cash value corridor immediately after the reduction
GUIDELINE PREMIUM AND CORRIDOR TEST (GPT)	Greater of:[5] **1.** Excess of (i) the aggregate premiums paid prior to the reduction in benefits over (ii) the adjusted guideline premium limitation for the contract; **2.** Excess of (i) the cash surrender value immediately before reduction in benefits over (ii) the maximum cash value permitted under the cash value corridor immediately after the reduction	Excess of (i) the cash surrender value immediately before reduction in benefits over (ii) the maximum cash value permitted under the cash value corridor immediately after the reduction

EXAMPLE[6]

In Year 1, A purchases a life insurance policy contract with $350,000 death benefit. The contract meets the definition of life insurance tested under the CVAT prescribed in §7702. The contract is not a MEC. A pays a total of $45,000 in premiums in Years 1-4 and at the end of Year 4 the policy's cash surrender value is $60,000.

A surrenders 60% of the contract and receives a $36,000 distribution from the contract. The death benefit also decreases to $140,000 as a result of the partial surrender. Based on A's age at the time of the surrender, the net single premium was $355 per $1000 of insurance coverage.

What amount of the $36,000 distribution, if any, is taxable to A?

Immediately prior to the surrender, the income built up inside the contract was $15,000 – [$60,000 CSV - $45,000 Basis = $15,000]

The partial surrender done at the end of Year 4 reduced the death benefit from $350,000 to $140,000. Because a reduction in benefits occurred in the first 5 years of the contract and the contract qualified under the CVAT approach, the recapture ceiling is the excess of:

(i) the contract's $60,000 CSV immediately before the reduction in benefits, OVER

(ii) the net single premium immediately after the reduction in benefits.

The net single premium for the contract's reduced death benefit was $49,700 – [$140,000 reduced death benefit x $355/$1000 net single premium = $49,700]

Consequently, the recapture ceiling is $60,000 - $49,700 = $10,300

Based on this recapture amount, of the $36,000 received by A, A must include all $10,300 into gross income. The remaining $25,700 of the distribution is treated as a return of a portion of A's $45,000 basis in the contract. A's basis in the contract immediately after the surrender is $19,300 – [$45,000 - $25,700 = $19,300].

6. How is the "investment in the contract" calculated? What is the difference between "investment in the contract" and "basis?"

Taxation of amounts received under a life insurance contract, e.g., surrenders, withdrawals, dividends, etc., are all governed by §72 and the owner's "investment in the contract."

A policy owner's "investment in the contract" is defined in §72(e)(6) and is equal to:

1. the aggregate amount of premiums or other consideration paid for the contract, ***minus***
2. the aggregate amount received under the contract to the extent such amount was excludible from income

Some examples of "amounts received" that would reduce the investment in the contract include: withdrawals, dividends received, surrendered PUAs, and rider charges.

In comparison, "basis" (aka "cost basis") applies to situations when gain or loss is determined under code sections *other than §72.* For example, if a policy is sold rather than surrendered, the policy owner's "adjusted basis" should control the tax treatment per §1001.

Basis generally equals the cost of the property as provided in §1012, adjusted for various factors. In gifting situations, basis generally is determined in accordance with §1015.

PLANNING NOTE

In most cases, "basis" and "investment in the contact" will be equal to each other; as such, these terms are often used interchangeably by industry professionals. However, there are instances where basis (or "adjusted basis") and investment in the contract could differ, so it is important to identify the tax transaction that is occurring to ensure proper taxation. See Question 8 for an example of where investment in the contract and basis leads to different tax results.

7. What are the tax implications of withdrawing cash value or paying off a policy loan immediately before or after a §1035 exchange?

IRC §1035 provides for the tax-deferred exchange of life insurance and annuities. Under a qualified "1035 exchange," a policy owner may exchange an existing life insurance policy for a new life insurance policy and defer any gain. Assuming the exchange falls under the purview of §1035, the newly acquired insurance policy will have the same basis and investment in the contract as the policy given up in the exchange.[7]

As discussed throughout this BYA, under §72, the owner of a life insurance contract can generally withdraw policy cash values up to the owner's investment in the contract without recognizing gain. However, §1035 exchanges are permissible under, and controlled by, §1031, not §72.[8] Under §1031(b), if an owner exchanges like-kind property but also receives "other property or money" in addition to the like-kind property, this additional property generally will be considered "boot."

Funds received by withdrawing cash value or paying off a loan using policy cash value during a 1035 exchange, or in close proximity before or after the exchange, generally will be considered "boot," which means that the policy owner will recognize income on the boot received to the extent of gain in the insurance contact.

For more information, please refer to our **BYA on 1035 exchanges.**

8. What are the income tax consequences of policy surrender resulting in a gain? Does the same hold true for policies that are sold versus surrendered?

When a life insurance policy or endowment contract is surrendered for its cash surrender value, the Code provides that any gain on the policy will be subject to ordinary income taxation to the extent the cash surrender value plus any policy loans outstanding at the time of surrender exceed the owner's *investment in the contract.*[9]

EXAMPLE

In year 1, Andrew purchases a permanent life insurance policy on his own life. In policy year 8, Andrew surrenders the policy for its cash surrender value of $78,000. Up until the time of surrender, Andrew paid premiums totaling $64,000 and has never taken a distribution or a loan from the policy. Under §72(e)(5), gain is determined by subtracting Andrew's investment in the contract (i.e., $64,000) from the amount received ($78,000- CSV). Andrew must recognize $14,000 of income on surrender of the contract.[10]

Prior to the enactment of the Tax Cuts and Jobs Act of 2017 (TCJA), the IRS had previously ruled in Revenue Ruling 2009-13 that in determining the amount of gain incurred in the **sale** (as opposed to a surrender) of a life insurance contract, the taxpayer's basis in the policy should be reduced by the "cost of insurance" charges incurred. With the enactment of the TCJA, Revenue Ruling 2009-13 was reversed and adjustments to basis for COI charges are no longer necessary. Consequently, the amount of gain from the sale of a life policy generally will be equal to the excess of the amount realized (i.e., value received in the sale) over the owner's adjusted basis in the policy, with no adjustment for COIs.

The gain resulting from a sale of a life insurance policy may have parts that must be treated as ordinary income and parts that must be treated as capital gain. According to the "substitute for ordinary gain" doctrine, the amount that would have been recognized as ordinary income in surrender should be recognized as ordinary gain in a sale. Any consideration in excess of this amount should constitute capital gain. In other words, capital gain treatment is recognized on the sale of a life insurance policy where the consideration exceeds the cash surrender value of the policy.

9. What are the income tax consequences of policy surrender resulting in a loss?

The general rule is that losses recognized upon surrender or sale of a policy are not deductible to the policy owner. However, in some cases, a taxpayer may be able to deduct a loss if the loss was incurred in a trade or business or in a for-profit transaction (IRC §165(c)).

10. Are policy loans taxable?

Loans taken out against a life insurance policy are generally not taxable (but see the discussion below if the policy is a MEC). As long as the policy remains in force, the loan will not be taxed (except that transferring a policy with loans in excess of basis usually triggers taxable income and is considered a transfer for value). Loans outstanding on a policy at the death of the insured will reduce the death benefit by the loan amount, but will not cause an income tax recognition event as death benefit is generally received income tax free under §101(a).

If a policy is surrendered with an outstanding loan, the loan reduces the surrender amount payable to the policy owner, but will not reduce the tax liability recognized by the taxpayer.

For example, if Ed owns a policy on his own life with a gross cash surrender value (CSV) of $100,000, an investment in the contract of $50,000 and an outstanding Loan amount of $75,000, upon surrender Ed will recognize $50,000 of ordinary income ($100,000 CSV – $50,000 Investment in the Contract) even though he only receives $25,000 ($100,000 CSV - $75,000 Loan) from the policy itself at the time of surrender.

These same rules apply to a contract that lapses with an outstanding loan.

Note that an important exception applies to MEC policies. Loans from MEC policies are taxable as income at the time the money is borrowed to the extent that cash value exceeds basis in the contract. An additional ten percent penalty may also apply to loans from a MEC. See Question 14 for more information on MECs.

11. Is the interest on a policy loan deductible?

Whether the interest on a policy loan is deductible depends on how the interest is classified for income tax purposes. Interest is typically classified in one of three manners: (a) trade or business interest; (b) investment or passive activity interest; or (c) personal interest.

A. *Trade or Business Interest*[11] – For contracts purchased after June 20, 1986, the deductibility of trade or business interest is significantly limited. Until 1996 legislation was passed, there was a general rule of non-deductibility for loan interest on company owned policies. For contracts issued after 1996, there is an exception to the general rule for policy loan interest paid on policies insuring a key person up to $50,000. Note, however, that interest in excess of the applicable federal rate cannot be deducted.

Legislation passed in 1997 further limited the deductibility of policy loan interest by adding a provision that generally provides that no deduction is permitted for the part of the taxpayer's interest expense that is "allocable to unborrowed policy cash values." Unborrowed policy cash value is the excess of the cash surrender value over the amount of the loan. There is an exception to this rule that applies to entity-owned policies that cover only one individual, who at the time first covered by the entity, is (1) a 20 percent owner of the entity or (2) an officer, director or employee of the trade or business.

B. *Investment/Passive Activity Interest* – If the loan proceeds were used to purchase an investment or for a passive activity, it is likely that the interest may be treated as investment interest or passive activity interest and will be deductible subject to investment interest limitations.

C. *Personal Interest* – Interest on a policy loan that is neither trade/business nor investment income (i.e. "personal") is not deductible under any circumstance.

Note, however, that even if a deduction is otherwise allowable, interest paid to purchase a single premium insurance contract will not be deductible.[12] Additionally, if premium payments are financed through policy loans, no deduction is allowable, unless certain exceptions are met.

12. Are dividends received from a life policy taxable?

Dividends received from a life insurance policy are treated as a distribution from the contract and taxed similarly to other types of distributions.[13] Accordingly, dividends are distributed income-tax free to the extent of the owner's investment in the contract – that is, dividends received reduce the owner's investment in the contract and only become taxable when the taxpayer's investment in the contract has been reduced to zero. Dividends are considered "received" regardless of whether they are paid in cash, used to purchase paid-up additions (PUAs), used to purchase one year term insurance or left to accumulate with interest.

When dividends are used to purchase paid-up additions, the owner's investment in the contract will be reduced by the dividend amount, but also will receive an increase in the same amount to account for the premium payment in the PUAs – effectively leaving the taxpayer in a neutral position relative to the taxpayer's investment in the contract.

Note that any interest on dividends held in an accumulated dividends account is also taxable to the owner in the year they are credited to his/her account, regardless of whether or not the interest is actually withdrawn.[14]

If the policy is a MEC, cash dividends paid to the owner will be considered income to the owner to the extent of any gain in the policy. These dividends may also be subject to a 10% penalty unless the owner is over age 59 ½ or is disabled. However, dividends used to pay premiums or purchase additional insurance are not taxable to the owner of a MEC contract.[15]

13. What are the income tax consequences of paid-up additions versus accruing dividends in a whole life policy?

Dividends used to purchase additional life insurance coverage are known as "paid-up additions." They allow the owner of a policy to purchase additional coverage without the need for additional premiums or medical underwriting. For income tax purposes, paid-up additions are treated in the same manner as the underlying base policy and will enjoy tax-deferred growth.

Alternatively, if dividends are left to accrue, and are not used to purchase additional insurance, the growth in the dividends is taxed as interest income. Because interest earned on accrued dividends will be taxable as ordinary income, electing to use dividends to purchase paid-up additions is often a more attractive option than accumulating dividends at interest.

14. How are Modified Endowment Contracts (MECs) taxed?

Policies entered into on or after June 21, 1988 that fail the 7-Pay Test (see Question 1), but otherwise meet the testing requirements for life insurance, are classified as modified endowment contracts ("MECs").[16] Single premium contracts are most often the culprit for MEC classification, although short-pay scenarios and/or a reduction in benefits on a non-MEC policy can create a MEC.

MECs generally enjoy the same income-tax free treatment of death benefit proceeds that non-MEC life insurance policies receive. Similar to non-MEC policies, cash value build-up within MEC policies also experiences tax-deferred growth. However, there is a notable difference between MEC and non-MEC policies regarding withdrawals from cash buildup within a policy. In MEC policies, withdrawals are taxed on a last-in, first-out basis (LIFO), which results in gain being withdrawn first and being immediately taxed as ordinary income. In comparison, withdrawals from a non-MEC policy are taxed on a FIFO basis, meaning that withdrawals are taxable as ordinary income only to the extent they exceed the owner's investment in the contract.

Distributions for the purposes of this rule include loans, pledging or assigning the MEC as collateral, dividends received, withdrawals and surrenders. Moreover, distributions taken prior to the taxpayer turning 59 ½ or becoming disabled may be subject to a 10% penalty tax.[17]

Grandfathered policies (i.e. contracts issued prior to June 21, 1988) are not subject to these MEC rules unless the contract fails the 7-Pay Test after a "material change" has occurred. A "material change" includes, but is not limited to, any increase in death benefit or qualified additional benefits (QABs) under the contract, except for:

- Increases that are attributable to the payment of premiums necessary to fund the lowest level of death benefit and QABs payable in the first 7 years of the contract, or
- Cost of living death benefit increases that are based on a broad-based index if such increase is funded ratably over the remaining period during which premiums are required to be paid.[18]

15. What is the taxation of a life insurance policy that does not meet the statutory requirements of IRC §7702?

If a life insurance contract fails the testing requirements under IRC §7702, the accrual of cash value within the contract will be taxable to the policyholder each year. If a contract is compliant under §7702 but later becomes non-compliant, the accrual of income for all prior taxable years will be treated as being received or accrued during the taxable year of non-compliance.

The death benefit associated with a non-compliant policy generally will be received by the beneficiary income-tax free to the extent that the death benefit exceeds the net surrender value of the contract.

16. What is the Transfer-for-Value Rule?

IRC §101(a)(2) provides that in situations where the life insurance contract or death benefit has been transferred for cash or valuable consideration, a portion of the death benefit becomes subject to income taxes. The amount of the death benefit that will be taxable income is the excess of the death benefit over the amount actually paid for the contract plus any premiums and other amounts paid by the transferee following the transfer.

Fortunately, there are exceptions to the transfer-for-value rule that are delineated in IRC §101(a)(2)(A) and (B) that can prevent the death benefit from being subject to income taxes after a transfer for value has occurred. Notably, if the transfer is made to any of the following, the death benefit is received income tax free:

- The insured individual
- A partner of the insured
- A partnership in which the insured is a partner
- A corporation in which the insured is a shareholder or officer

Transfers of a policy whereby the transferee takes the transferor's basis (in whole or in part) in the policy are also exempt from the transfer for value rules. Examples of basis transfer includes: gift of policies, transfers between spouses, and transfers subject to a tax-free corporate reorganization.

Under the 2017 Tax Cuts and Jobs, a transfer-for-value issue may arise if there is a "reportable policy sale." A "reportable policy sale" is defined generally as the acquisition of an interest in a life insurance contract, directly or indirectly, if the acquirer has no substantial family, business, or financial relationship with the insured (apart from the acquirer's interest in the life insurance contract). The law provides that the exceptions to the transfer for value rules under IRC §101(a)(2)(A) do not apply in the case of a transfer of a life insurance contract, or any interest in a life insurance contract, in a reportable policy sale. Thus, some portion of the death benefit ultimately payable under such a contract may be includable in income. The new basis rule is effective for contracts issued after August 25, 2009; otherwise these provisions are effective for reportable sales entered into, and reportable death benefit received, after December 31, 2017.

For more in-depth coverage of this topic, please see our **BYA on Transfer for Value**.

17. Are premiums paid on personal life insurance deductible?

Life insurance is considered a personal expense and premiums paid for coverage are typically not deductible under IRC §264. Exceptions may include premiums paid by an individual on behalf of a policy owned by a charity.[19] Furthermore, insurance premiums paid for by an employer in the employee benefit context may also be deductible (see Question 21).

18. What is the taxation of charges against cash value for a Long-Term Care (LTC) Rider?

For tax years *after* December 31, 2009 (effective date of the Pension Protection Act of 2006), the LTC rider charge against the cash value of an insurance policy is not included in income, but will reduce the investment in the contract (but not below zero).[20] This rule applies whether the life insurance contract is classified as a modified endowment contract (MEC) or not.

For tax years beginning *before* January 1, 2010, LTC charges were treated as partial withdrawals. If the policy was a MEC, those withdrawals were taxable income to the extent that there was gain in the policy. The 10% penalty may also have been applicable to those withdrawals. If the policy was a MEC but there was no gain in the contract, the withdrawals reduced the owner's investment in the contract, same as with non-MEC policies.

19. What is the tax treatment of the death benefit for employer-owned contracts under §101(j)?

IRC §101(j) provides that the death benefit received on an employer-owned life insurance contract will not receive tax-free treatment unless certain requirements are met. To meet these §101(j) requirements, prior to the policy being issued, the employer must provide the insured-employee with notice that the employer is obtaining life insurance on the employee's life (and the amount for which the employee may be insured) and obtain consent from the employee agreeing to this purchase.

Additionally, ***one*** of the following scenarios must also be met to keep the policy proceeds income-tax free:

- Insured-employee was an employee at any time during the 12 month period preceding the employee's death;
- Insured-employee was a director or highly compensated individual at the time the policy was issued;
- Death benefit is paid to a member of the insured's immediate family, to an insured's designated beneficiary, to the insured's estate or to a trust for the benefit of the insured's family; or
- Death benefit is used to purchase an equity interest in the business from the insured's family or trust.

For more information, please see our **BYA on Employer-Owned Life Insurance (EOLI)**.

20. How is group term insurance taxed to an employee?

Under an employer-provided group term life insurance plan, the premium cost for the first $50,000 in coverage does not have to be reported as income and will not be taxable. Amounts in excess of $50,000 will be considered "imputed income" and will trigger taxable income to the employee in the amount of the "economic value" of the coverage. Taxable amounts are subject to ordinary income tax rates.

21. Are premiums paid by an employer for life insurance tax deductible by the employer?

It depends. Premiums paid by an employer for group life insurance are usually deductible by the employer as a business expense. Premiums paid by an employer for a policy owned by the employee as part of a bonus plan (typically referred to as a 162 Bonus) also are generally deductible as a business expense.

Premiums paid by an employer on a policy owned by the employer – e.g., key man policy or policy purchased for buy-sell funding or funding a deferred compensation plan – are not deductible per §264.

22. What are the tax implications if an employer owns a policy on an employee's life but allows the employee to name a beneficiary for some or all of the death benefit?

When an employer owns a life insurance policy on an employee's life and allows the employee to name a beneficiary for all or a portion of the policy (e.g. his/her spouse, children, trust, etc.), the arrangement is governed by the Final Split Dollar Regulations ("Final Regulations").[21]

These Final Regulations call for the employee to recognize into income each year the "economic benefit" associated with the death benefit being provided to the employee's family. This economic benefit cost represents the term cost associated with the insurance death benefit. If the employee does not recognize this economic benefit cost into income, the Final Regulations provide that the death benefit paid to the employee's family is subject to income tax as if the employer had paid this amount out as compensation.[22]

For more information on split dollar arrangements, please see our **Split Dollar Client Guide**.

1. IRC §7702(b)(1).
2. See IRC §7702A.
3. IRC §7702(f)(7)(D).
4. IRC §7702(f)(7)(C)(i).
5. IRC §7702(f)(7)(C)(ii).
6. Rev. Rul. 2003-95.
7. See Rev. Rul. 2002-75.
8. Priv. Ltr. Rul. 8905004.
9. See IRC sec 72(e)(A) and Blum v. Higgins, 150 F.2d 471 (2nd Cir. 1945).
10. See Rev. Rul. 2009-13, Situation 1.
11. IRS Publication 525 (2015).
12. IRC §264(a)(2).
13. IRC §72(e)(1)(B).
14. *Theodore H. Cohen v. Comm'r.*, 39 T.C. 1055 (1963).
15. IRC §72(e)(4)(B).
16. IRC §7702A.
17. IRC §72(v).
18. IRC §7702A(c)(3)(B).
19. See, §170(a).
20. Section §72(e)(11).
21. See Treas. Reg. §1.61-22.
22. Treas. Reg. §1.61-22(e)(3).

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