



Tax Questions



Are there income tax implications associated with an endowment policy?

Yes. As the cash value in your Start Smart College Plan increases, it will generate taxable income. After your application has been approved, we will send you a notice containing important income tax information. The notice will provide a more detailed explanation of your policy including the expected taxable income along with cash value and other benefits for each policy year. In addition, Gerber Life will send IRS Form 1099-R to you, the policy owner, for each year that there is taxable income – just like a bank or mutual fund company would do if you saved or invested with them.

Why is there taxable income? I thought life insurance was tax-free?

An individual endowment's cash values grow much quicker than a life insurance policy. Because of the rapid growth of cash value an individual endowment will generate taxable income when the cash value exceeds certain limits imposed by the Internal Revenue Service. Because of this, the IRS considers the individual endowment an investment and taxes it like other investments, even though the policy is still considered a life insurance policy.

The amount of taxable income is calculated using a method described in the Internal Revenue Code. If a death benefit is paid, the amount paid as a death benefit (*Endowment Amount less Cash Value*) will generally be income tax free.

Taxable income usually doesn't start until several years after the policy has been in force. In the first year that there is taxable income, the amount will be slightly larger than in subsequent years. This is because the Internal Revenue Code requires insurance companies to use methods that combine several years of cash value growth.

It is the responsibility of Gerber Life to tell you when there will be taxable income, to calculate the amount of your taxable income, and to provide the information to you on an IRS Form 1099-R. The income reported on your 1099-R should be added to your other income and reported on your tax return. The IRS also requires that we send them a copy of your 1099-R.

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Does Gerber Life withhold any of the taxable income?

The IRS requires the life insurer issuing the policy to withhold 10% of the taxable income if it exceeds \$200 in any year, unless you elect not to have Gerber Life do the withholding. **Generally, paying the tax yourself will be a better option for the following reasons:**

- **The only way for Gerber Life to withhold money for taxes is to take a loan from your policy.** When we take a loan, we are required to charge 8% interest. Therefore, we strongly recommended that the policy owner “elect out.” This means that the policy owner will be required to pay any taxes due, just as with all other sources of income.
- **By “electing out,” the policy owner will not have loans and loan interest reducing the maturity payout.** If Gerber Life takes policy loans to pay the tax for you, the amount paid from the endowment at maturity will be less than the face amount, unless the loan and interest are repaid prior to maturity. (*Endowment Amount less Total Outstanding Loan and Loan Interest = Final Payout*)
- Before we can put your endowment into effect, we must receive your first premium payment AND a signed Federal Income Tax Withholding Election Form. This is the form you would need to use to either “elect out” or agree to having Gerber Life withhold 10% of the taxable income for you. In either case, you may be responsible for paying estimated taxes. Therefore, we suggest you consult with a tax adviser to determine if you need to file estimated taxes.

What are 1035 exchanges? Is the Start Smart College Plan eligible for such an exchange?

Internal Revenue Code Section 1035 Tax Free Exchange generally allows a taxpayer to transfer cash value from one life insurance policy to another, or from a life insurance policy to an endowment or an annuity, without paying any income tax on the cash value. Tax on the cash value would be due only if the total cash value exceeded the amount of premium that was paid into the policy. Any loans would be added back into the total cash value.

Because Gerber Life’s Start Smart College Plan is a fixed-premium product, a transfer of cash value from one policy to another is not generally possible. Therefore, the transaction will not qualify for tax-free 1035 treatment. Any cash value in excess of the first year’s premium would be put into a pre-paid premium account. Because the excess cash value is paid into the account and not moved entirely into the endowment policy, it would not qualify under IRC Section 1035.



Gerber Life Insurance Company

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