# Taking Stock: 1035 gets big 10-4

*by Malcolm Berko*

Dear Mr. Berko: I think I have a good but unusual problem. In late 2002, I wrote and told you that my wife and I sold our huge home in Durham, N.C., because our children are gone and married. We sold that home and moved into a much smaller but very comfortable new home. After buying the smaller home we had $83,000 in cash remaining. Our only stock market experience is about $101,000 in some utility stocks that have done very well over the past 30 years we've owned them because we have reinvested all the dividends. When we asked you what to do with $83,000, you advised us to put it into an Equitable variable annuity because we did not want any risk, because it guaranteed to pay us 6 percent on our $83,000 investment, because it was tax-deferred, because Equitable would guarantee our $83,000 death benefit no matter how bad the market performed and because it would increase in value if the market did. Well, all those things happened and our variable annuity after three years and four months is worth $142,000. And we are very grateful for your wise advice.

Now here's our worry. What if the stock market gets weak and the Dow Jones falls by 10 percent or 25 percent? The value of our investment could easily go back to the guaranteed $83,000 and we'd be back right where we started. But if we sell it before the contract period ends (like today) we will have to pay ordinary income tax on a $59,000 gain plus a 6 percent "early-out" penalty fee to Equitable based on our $83,000 investment. So what do we do to protect ourselves? Sell the annuity and pay the taxes or continue to hold it and hope the market doesn't fall? And at our ages (70 and 72) we are concerned that we may not have enough time to ride it out. But we would like to preserve and guarantee our $59,000 gain. How can we do this?

G.T.

Port Charlotte, Fla.

Dear G.T.: You've asked a question that's extremely important to many investors who own Equitable and other variable annuities. And while I'd like to believe that the market will continue its uninterrupted upward momentum, I'd be a fool and a blithering idiot if I did.

Oh, I think the market will continue higher. In fact I'm convinced that it will continue much higher and that the Dow Jones Industrial Averages could exceed 25,000 in the next dozen years or so. And 25,000 is not much of a stretch because that gain represents a 6 percent average annual compounded return over the coming dozen years. However, between now and then, it's quite likely that there will be some serious declines and those declines (possibly in the neighborhood of 2,000 or 3,000 points) will be mighty scary. I guarantee it! And in the process many investors will get a severe dose of the megrims, the fantods and perhaps serious case of PSMD (post-stock market disorder).

But you're right as a rain: the value of your Equitable annuity could fall back to $83,000 and you will have lost all your gain. And you're also right as a rainbow: if you liquidate your annuity you will have to pay ordinary income taxes on your gain plus a 6 percent "early-out" (before the eight-year contract period ends) penalty.

But there's a solution and it's called a "1035" exchange transfer to another variable annuity which will accomplish five objectives and put you way ahead of the curve ball. So:

1. The 1035 transfer allows you to move a low-cost basis annuity to another insurance company and avoid federal income taxes on the gain in value. So if you move your Equitable annuity worth $142,000 to (for example) MetLife's variable annuity there will be zero tax consequences.

2. You will then lock in a new $142,000 market value "living benefit," which with MetLife steps up every year. Your old Equitable living benefit never steps up but its death benefit (to the beneficiary) does every five years.

3. MetLife will guarantee you 6 percent income on $142,000 or $8,520 vs. Equitable guarantee of 6 percent income on $83,000 or $4,980 and which is a $3,540 difference.

4. MetLife will credit you a 5 percent signing bonus on $142,000 or $7,100, which will nullify the 6 percent "early-out" penalty of $4,980 that you must give up to Equitable.

5. While your living benefit with Equitable will always be $83,000, your living benefit with MetLife (which never decreases) will increase every year as the market value rises. So if the MetLife policy grows to $160,000 next year your new "lock-in" living benefit is $160,000 and MetLife guarantees you 6 percent income on $160,000 or $9,600. And it can never be less.

This 1035 exchange solves your problem. It locks in the higher market value for your living benefit. The higher value is locked in very year and the 6 percent income guarantee will always be based on the higher value even if the stock market falls 10 percent or 25 percent. And that's a humdinger deal.

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