

## Advanced Planning: Trust-Owned Annuities: From Basics to Pass In-Kind Wealth Transfers

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**Presenter:** Hello, my name is Carlos Zarate. I'm with the advanced planning team here at AuguStar financial. A lot of the conversations I have as the annuity specialist on our team revolves around trust owned annuities.

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**Presenter:** That will be the focus of our discussion today. Trust owned annuities can be very complex with a lot of moving parts. There can be benefits if the trust owned annuity is structured properly. As a financial professional, if you are working with a client and the topic of trust-owned annuities arises, one of the first questions you should address is whether that trust in question can purchase an annuity, or any investment for that matter. To answer this question requires a review of the trust document and all related documents. As a fiduciary, the trustee must follow the guidelines of that trust agreement and decide if an annuity is an appropriate investment, based on the goals of the trust. There are many reasons a trust may be formed, including avoiding probate, asset protection from creditors including ex-spouses, planning for a child with special needs, controlling how and when assets are distributed, minimizing estate taxes, among many other potential reasons. The reason a trust may own an annuity can range from something as simple as a competitive annuity interest rate or a much more complex goal such as a pass in-kind wealth transfer, which we will discuss in depth here shortly.

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**Presenter:** But let's first discuss some annuity basics. As many of our listeners will already know, when you fund an annuity with non-qualified dollars, earnings on the annuity will be tax deferred.

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**Presenter:** This is one of the key advantages of annuity contracts. I specifically mention non-qualified money because if you fund an annuity with qualified money like an IRA (also, IRA and other qualified retirement accounts generally cannot be transferred to a trust during lifetime), it of course is already tax deferred. So, you're adding an extra layer of benefit when investing non-qualified money into an annuity. So, Trust owned annuities can still qualify for tax-deferral. The key here is the trust must be acting as an agent for a natural person. Let's walk through an example. Say Grandpa has a living trust, the trust purchases an annuity, grandpa is the annuitant (the measuring life) on the contract, and the trust is the beneficiary. This is a very simple way to structure a trust owned annuity. And because the trust is acting an agent for a natural person (Grandpa) the annuity gets tax-deferral and when distributions are made, they will be taxed at his individual ordinary income tax rate. So that's a straightforward example.

Let's zoom in on what happens if Grandpa were to pass away. As the annuitant, his passing would trigger a death benefit on the annuity and since the trust is the beneficiary of the contract, the trustee would have to sign the death claim paperwork. In a scenario where his wife was the beneficiary of the trust, we could look through the trust and one of her options could be to elect spousal continuation on the annuity, meaning she would become the new annuitant and could continue the contract as is. She would also have the option of liquidating the account as well. What about a scenario where a son or daughter was the beneficiary of the trust? There are typically three options here. A.) the son or daughter could take a lump sum. B.) delay taking funds for up to 5 years or C.) elect a stretch option based on his or her life expectancy. This last option is only available if we can identify a natural person as the beneficiary of the trust. Even then, there is an indemnification process that must be completed to allow this option. The advantage of this stretch is it allows for the bulk of the asset to continue growing tax deferred, while minimum distributions are taken out annually based on life expectancy. Note: even though this is technically an option at AuguStar for certain kinds of trusts, many annuity carriers will not allow for the stretch death benefit election for trusts no matter what the structure of the trust.

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**Presenter:** The last piece of this conversation I want to touch on is the pass in-kind annuity distribution. Multigenerational legacy planning can be very complicated.

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**Presenter:** But knowing your way around sophisticated wealth transfer concepts can be hugely advantageous. The pass-in-kind strategy can provide multiple generations of tax-deferral on the annuity contract – a unique tax advantage that may not be available with many other types of assets. An in-kind distribution begins with your client purchasing a trust owned annuity contract for each of their beneficiaries. Each beneficiary would be the annuitant or measuring life of a separate annuity contract. If the annuitant is living and the trust allows, AuguStar may permit an in-kind distribution of the annuity to the annuitant. So, ownership would change from trust to annuitant. Practically, this is done through an ownership change request form. The trust beneficiary/annuitant receives a tax-deferred asset that retains its tax-deferred status until the beneficiary takes distributions from the annuity. Several Private Letter Rulings or PLRs have supported this strategy as a non-taxable event when the annuitant is the beneficiary of the trust. But before looking at a detailed example of an in-kind distribution, we must give a little more background on PLRS. Much of the guidance for complex rules around trust-owned annuities is contained in IRS private letter rulings or PLRs. A PLR only legally applies to the taxpayer who requested the ruling and is not official tax code. Still, PLRs often serve as guidance for estate and tax planners because they give a window into what the IRS is thinking and how it may handle similar cases. So, we've discussed PLRs, now let's look at an in-kind distribution case study. Let's say Patricia is the income beneficiary of a family trust her husband created before his death. Their children, Keith and Theresa are named remainder beneficiaries of the

trust. The trust purchases two AuguStar deferred annuities, naming Keith as annuitant on one and Theresa annuitant on the other. So, the trust is the owner, but the kids are the annuitants on their respective contracts. The annuities will grow tax-deferred over Patricia's life, and when she dies, the kids can submit a change of ownership and replace the trust as owners on their respective annuities. Remember, based on PLRs, this is not a taxable event, so Keith and Theresa will continue receiving tax-deferred treatment on annuities they now own outright. This tax-deferred annuity was passed in-kind over multiple generations without triggering a taxable event. As mentioned above, in the case of multiple beneficiaries each trust beneficiary should be the annuitant of a separate contract, and separate trusts (or sub-trusts) are often used. In any case, an attorney should carefully draft the trust to align with the facts in favorable PLRs. To learn more about pass in-kind distributions and other trust owned or trust as beneficiary concepts, please reach out to the advanced planning team here at AuguStar Financial.

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This podcast was produced in June 2025 and is filed as 10244FMP.

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