

ADVANCED PLANNING

How deferred annuities can help trustees win

Trustees tasked with the selection and management of trust investments have numerous options. Traditional investments – stocks, bonds, mutual funds, and managed accounts – immediately come to mind. But don't sleep on deferred annuities. They are worthy of strong consideration as part of a well-balanced investment approach. They provide guaranteed income, and tax planning flexibility.

A tricky balancing act

Trustees are tasked with acting in the best interests of trust beneficiaries. This is often tricky because most trusts have two classes of beneficiaries with seemingly competing interests: (1) lifetime beneficiaries who depend on trust income for maintenance and support; and (2) remainder beneficiaries who stand to receive distributions, usually at the death of the lifetime beneficiaries. Most commonly, this arises in a family setting where a spouse is the lifetime beneficiary, and the children and grandchildren are the remainder beneficiaries. Balancing the need for periodic lifetime income while prudently protecting wealth for future generations is challenging.

The power of deferred annuities

Deferred annuities can help trustees achieve a healthy balance. Deferred annuities provide a unique combination of potential benefits:

Capital protection

A deferred annuity is an insurance-based investment which can provide guaranteed income regardless of how equity or interest rate markets perform. The potential to preserve and grow capital is a significant advantage when considering the volatile nature of many traditional investments.

Growth and Income

One of the hallmarks of annuities is the potential to grow income over time. Trustees are generally required to make trust assets productive which includes the requirement to generate a reasonable amount of income. Many trusts require a lifetime income stream to support a beneficiary - for example, a trust designed to provide a surviving spouse with income for life. Adding an annuity with guarantees to a trust investment portfolio may help achieve this goal while minimizing risk and volatility.

Flexible tax management

One of the prime benefits of a deferred annuity is the ability to toggle income on and off. Assuming the trust is properly drafted and administered, an annuity contract remains tax-deferred until such time as income is desired.¹ The flexibility of a deferred annuity allows the trust to avoid taxation in the years when taxable income is not desired.

Tax diversification

Some trust assets are subject to ordinary income taxes annually (such as CDs and business income) while other assets are subject to capital gains taxes (such as real estate and stocks). Annuity contracts represent a different "tax-deferred bucket" which can complement the other asset types to create a well-rounded, tax planning strategy.

Why is planning for trust income challenging?

To discourage trusts from accumulating large amounts of wealth outside the estate tax system, the IRS applies extremely compressed income tax rates to trust taxable income. In 2025, the highest bracket (37%) is reached at only \$16,000 of trust income versus \$768,700 for a married couple filing jointly – **a difference of \$752,700!**

These higher tax rates consume trust values, potentially leaving less wealth for beneficiaries. Tax deferred annuities can help.

2026 Income Tax Rates			
Trusts and estates		Married filing jointly	
10%	\$0 - \$3,300	10%	\$0 - \$24,800
24%	\$3,301 - \$11,700	12%	\$24,801 - \$100,800
35%	\$11,701 - \$16,000	22%	\$100,801 - \$211,400
37%	Over \$16,000	24%	\$211,401 - \$403,550
		32%	\$403,551 - \$512,450
		35%	\$512,451 - \$768,700
		37%	Over \$768,700

Non-taxable exit strategy

Most trusts, even multigenerational trusts, are designed with an end in mind. A time comes when remaining trust assets will be distributed to beneficiaries, often the children and grandchildren of the trust creators.

When managing investments, trustees should consider the need for an efficient exit strategy. Deferred annuities offer an approach that can allow for continued tax deferral without the need to liquidate taxable investments:

- The trustee purchases a trust-owned annuity for each of the trust beneficiaries at the time of purchase, the trustee submits a completed Trustee Certification (Form V-4603)
- Each trust beneficiary is the annuitant (the measuring life) of a separate annuity contract
- At the trust creator's death, the trustee submits an annuity ownership change request form, changing ownership from the trustee to the annuitant (the trust beneficiary)

This powerful exit strategy may allow the annuity to continue growing tax-deferred for the new owner (the trust beneficiary annuitant).²

Annuity contracts offer these and other powerful benefits for trustees to consider when building a well-rounded investment portfolio.

¹ Trust-owned annuities can qualify for income tax deferral if the trust is holding the annuity on behalf of a natural person beneficiary (IRC Sec.72(u)). These rules apply to annuity contributions made after February 28, 1986. At AuguStar, we require the trustee to sign a form acknowledging their ability to seek independent tax advice regarding the trust-owned annuity contract, and AuguStar makes no representations or warranties regarding the tax treatment of the annuity.

² This strategy is based on IRS Private Letter Rulings (PLRs). A PLR only applies to the taxpayer who requested the ruling and cannot be used as legal authority. Still, PLRs often serve as guidance for estate and tax planners because they give a glimpse into what the IRS is thinking and how it may handle similar cases. You should always work with your own tax and legal professionals in your particular case.

This material provides general information that should not be construed as specific tax or legal advice nor the law of any particular state. You should seek the advice of a qualified tax or legal professional for your specific situation.

Annuities are long-term investment vehicles designed to accumulate money on a tax-deferred basis for retirement purposes. Upon retirement, annuities may provide an income stream or a lump sum. If you die during the accumulation or payout phase, your beneficiary may be eligible to receive any remaining Contract Value.

Annuity Issuer:

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There is no additional tax-deferral benefit for contracts purchased in an IRA or other tax-qualified retirement plans because such retirement plans already have tax-deferred status. An annuity should only be purchased in an IRA or qualified plan if the contract owner values some of the other features of the annuity and is willing to incur any additional costs associated with the annuity.

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