



ADVANCED PLANNING

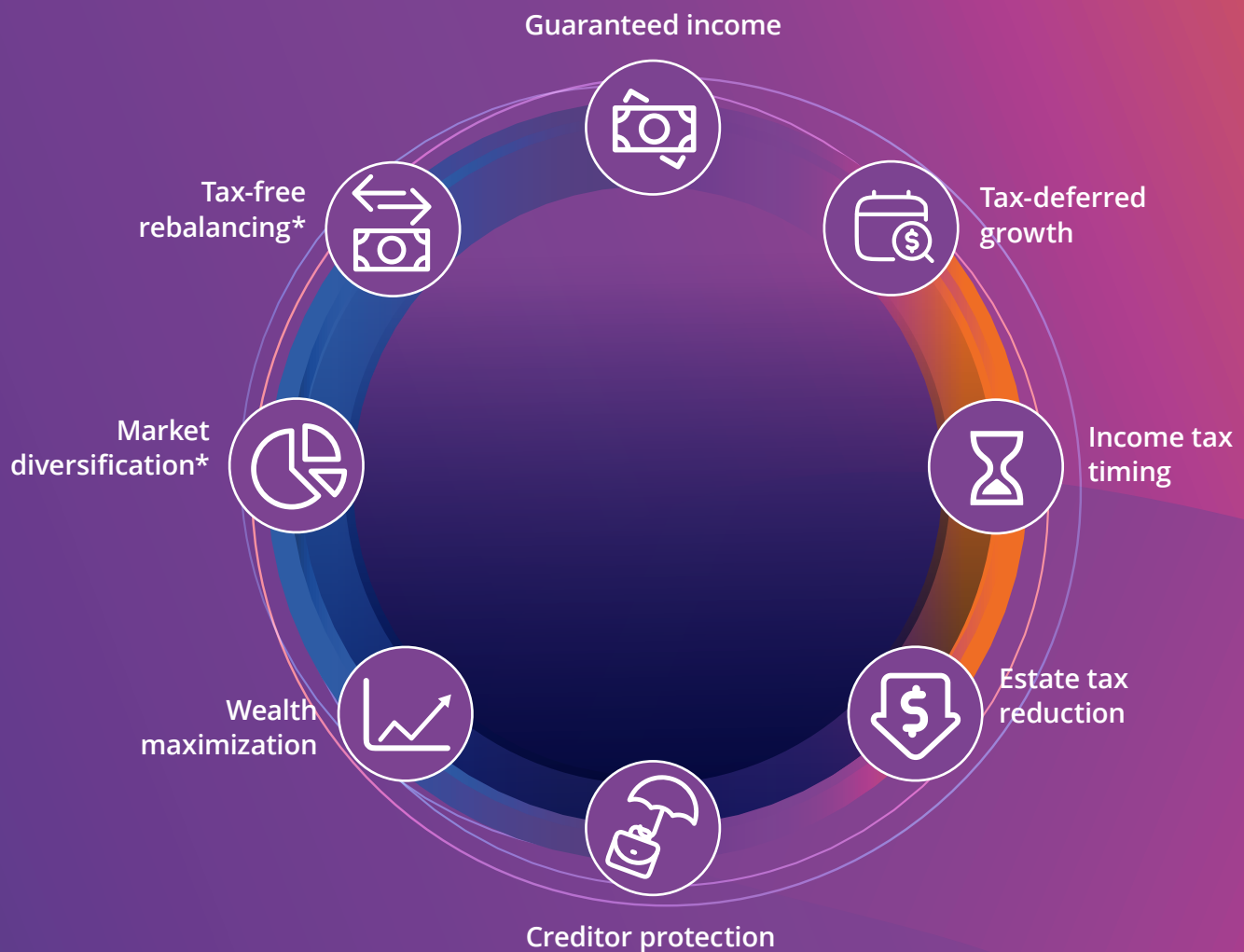
Dynamic estate planning with trust-owned annuities



A powerful combination

Trusts and annuities are powerhouse estate and financial planning tools. When combined in a carefully crafted plan, they can create a dynamic legacy for you and your heirs.

There are a variety of potential benefits when an annuity is held by a properly structured irrevocable trust – a type of trust that generally is permanent and has specific instructions both during your lifetime and after death:



When considering these strategies, it is helpful to first review the basics of trust and annuities. By reviewing the fundamentals, we will learn where annuities fit.

*Additional benefits unique to variable annuities

Qualified vs. non-qualified annuities

Annuities are either “qualified” or “non-qualified.”

Generally, a qualified annuity is typically funded with pre-tax dollars and held inside an Individual Retirement Account (IRA) or a qualified retirement plan (such as a 401(k) or a 403(b) plan). On the other hand, annuities purchased with after-tax dollars outside of these plans are typically known as non-qualified annuities.

A third, unique category is **annuities held inside Roth accounts**. Annuities held inside Roth accounts are still “qualified” because they are held inside an IRA or qualified retirement plan, even though they are generally funded with after-tax dollars.

What is an annuity?

An annuity is a contract purchased from an insurance company to provide a guaranteed income stream for life.

Annuities may include a variety of living benefit and death benefit features that are backed by the strength and stability of the insurance carrier. While life insurance is typically thought of as protection against early death, an annuity can be thought of as protection against outliving income.

Annuities come in different varieties, and individuals are often wise to consider annuities as part of a well-rounded retirement investment portfolio.

Qualified

Pre-tax dollars

Example: Annuity purchased inside a Traditional IRA or 401(k)

Non-qualified

After-tax dollars

Example: Annuity purchased and owned individually or owned by a trust

Qualified Roth

After-tax dollars (or by Roth conversion)

Example: Annuity purchased inside a Roth IRA

The biggest difference between qualified and non-qualified annuities is how distributions are taxed and, in some cases, to what extent you can access funds.

There is also a difference as to whether a trust can own qualified or non-qualified annuities.

Qualified annuities (including Roth)

While a trust cannot own a qualified annuity, a trust can be the *beneficiary* of a qualified annuity (for example, the beneficiary of an IRA). This might be appropriate where the account owner/plan participant desires to flow dollars through a trust as part of an estate plan. For example, the account owner might want to leave her beneficiaries a more structured inheritance, flowing her IRA dollars through a trust (rather than an outright gift) to help provide her beneficiaries with investment management and creditor protection.

Non-qualified annuities

In contrast with qualified annuities, a trust *can* own a non-qualified annuity, assuming the trust document allows. For example, a trustee might purchase a non-qualified annuity inside the trust to manage investment expectations and to benefit the trust beneficiaries – such as a spouse, children, grandchildren, or other heirs of your choosing. And in most cases, when the trust owns the annuity, the trust is also listed as the beneficiary of the contract.

What is a trust?

A trust is a legal vehicle for holding and distributing assets during lifetime, at death, and beyond. Like annuities, trusts come in many varieties, each with its own powerful set of benefits.

The person creating the trust is the grantor (or settlor). A trust can have multiple grantors, such as a married couple creating a trust. The trust is set up to benefit one or more beneficiaries. There may be current income beneficiaries – such as a spouse – and remainder beneficiaries – such as children or grandchildren. The trustee holds and manages trust property for the exclusive benefit of the beneficiaries and must use care to fulfill the terms of the trust.

The two primary types of trusts are living trusts and testamentary trusts. Of the two, you may be more familiar with living trusts. These trusts are created during your lifetime and take effect immediately as you put assets in your trust.

Testamentary trusts are different. A testamentary trust is a unique type of trust created within a will. It does not take effect until death (more specifically, after the will is submitted to probate).

Revocable vs. irrevocable trusts

Trusts are either revocable or irrevocable. With a revocable trust, the grantor can change or terminate the trust during their lifetime. The primary benefits of a revocable trust are:

- Avoids the cost, delays, and publicity of probate
- Provides control over distributions for heirs
- Offers incapacity planning during lifetime
- Gives privacy as to your assets and estate distribution plan

With irrevocable trusts, on the other hand, the terms of the trust are generally set in stone with some few exceptions. The primary benefits of a properly structured irrevocable trust are typically:

- Estate, gift, and generation-skipping transfer tax reduction
- Multi-generational estate and financial planning
- Enhanced creditor protection

In most cases, irrevocable trusts are for individuals with large estates or for those who live in a state with a separate estate and/or inheritance tax. If you have a potential estate tax problem, then an irrevocable trust might be right for you.

An irrevocable trust might also be appropriate if you are concerned about creditor protection (for example, if you work in a high-risk profession). If creditor protection is a concern for you, you should work with a local attorney as creditor protection laws vary by state.

Are there other ways to protect my heirs?

If you want to control how and when heirs can access funds – such as a beneficiary who isn't prepared or able to inherit a large sum of money – a trust is typically the most sophisticated way to go. Depending on your situation, the trust could either be revocable or irrevocable.

For a simple, cost-effective solution, use AuguStar's® beneficiary settlement form. It offers several robust options for limiting how much (and when) your beneficiary receives proceeds from your non-qualified annuity contract.

Income tax for trusts

Understanding trust income tax rules is essential to understanding the benefits of trust-owned annuities.

With non-grantor trusts, who pays the tax bill?

In the case of a non-grantor trust, if trust income is distributed to the beneficiaries during the tax year, the income is generally taxable to those beneficiaries.

However, if trust income is accumulated, the trust itself is taxed on the income received.

A trust is generally taxed as either a grantor or non-grantor trust.

A **grantor trust** often has the same tax ID number as the grantor during the grantor's lifetime. All items of trust income, deduction, and credit are reported as the grantor's own.

Most revocable living trusts are also grantor trusts during the grantor's lifetime. Because the grantor can change or amend the trust, it is as if the grantor continues to "own" trust assets from an income tax perspective.

A **non-grantor trust**, on the other hand, is a separate taxpaying entity – it is distinct from the grantor's personal income taxes. These trusts typically have a separate tax ID number known as an employer identification number or "EIN."

As mentioned above, most revocable trusts are taxed as grantor trusts. Irrevocable trusts tend to have more variety: irrevocable trusts can be taxed as *either* grantor or non-grantor trusts, depending on the goals and objectives in setting up the trust.

Irrevocable grantor trusts have the unique ability to potentially separate estate taxes from income taxes. The trust can be structured so the assets pass outside the grantor's estate – free of estate taxes – by virtue of being an irrevocable trust. Meanwhile, income tax liability remains with the grantor – at the grantor's individual income tax rates – by virtue of being a grantor trust. When the grantor passes (or both grantors in the case of a typical trust with two grantors), the trust becomes a non-grantor trust for income tax purposes.

Revocable trusts

Grantor trust
(while the grantor is alive)

Irrevocable trusts

Grantor trust
Non-grantor trust

TIP: If you are not sure how your trust is taxed, reach out to your attorney to discuss.

The income tax bracket crunch

This discussion matters because *individual* income tax brackets and rates are more favorable than *trust* income tax brackets and rates. An example helps illustrate this point.

Remember that income received by grantor trusts is taxed to the grantor as an individual. Here is an example of income tax brackets for married individuals filing jointly in 2025. Importantly, see that a married couple filing jointly does not hit the highest income tax bracket of 37% until over \$751,600 of income.

Married filing jointly (MFJ)		Trusts and estates	
Tax rate	Taxable income	Tax rate	Taxable income
10%	\$0 to \$23,850	10%	\$0 to \$3,150
12%	\$23,851 to \$96,950	24%	\$3,151 to \$11,450
22%	\$96,951 to \$206,700	35%	\$11,451 to \$15,650
24%	\$206,701 to \$394,600	37%	Over \$15,650
32%	\$394,601 to \$501,050		
35%	\$501,051 to \$751,600		
37%	Over \$751,600		

Source: Internal Revenue Service. Please note the chart has been simplified for this guide and does not include a breakdown of the flat amount owed in each bracket.

On the other hand, the income tax brackets for trusts and estates are very harsh. See from the above tables that in 2025, a trust hits the highest income tax bracket of 37% at just over \$15,650 of income—a far cry from over \$751,600.

To make matters worse, the tax code imposes an additional 3.8% tax on net investment income – which generally includes income from non-qualified annuities – for certain individuals, estates and trusts. This tax also impacts trusts more harshly. For example, for a single (individual) taxpayer, this additional tax on net investment income is based on an earned income threshold of \$200,000. If the taxpayer is a non-grantor trust, on the other hand, the threshold is much lower: only \$15,650 in 2025! This means trusts are more likely to pay even more tax.

As mentioned above, the trustee of a non-grantor trust could potentially distribute income to the beneficiaries during the tax year. Income is then taxed to those beneficiaries – at their individual rates – rather than to the trust at the harsh trust rates.

Distributions can be tricky

While the individual beneficiaries are likely in a better tax bracket than the trust, distributions to beneficiaries can be problematic for several reasons.

The distributed income could:

- Increase the beneficiary's taxable income (potentially bumping them into a higher tax bracket);
- Increase the beneficiary's taxable estate for estate tax purposes;
- Be subject to creditors and predators;
- Be against the beneficiary's best interest; and
- Reduce the size of your legacy in trust for future generations

Factors for trustees to consider

A trust-owned annuity may not be appropriate in every situation. Trustees should consider several factors, including:

State law: Applicable state laws governing trustees, such as any state version of the Uniform Prudent Investor Act that includes standards for trustees to consider when investing trust assets;

Trust language: Any language in the trust on treating beneficiaries fairly, including whether priority is given to income versus remainder beneficiaries;

Beneficiaries: Number of trust beneficiaries and their situations;

Timing: Time horizon/duration of the trust and the annuity contract;

Fees: Costs and fees associated with the annuity; and

Tax deferral: Whether the trust-owned annuity will qualify for tax deferral (discussed later in this guide).

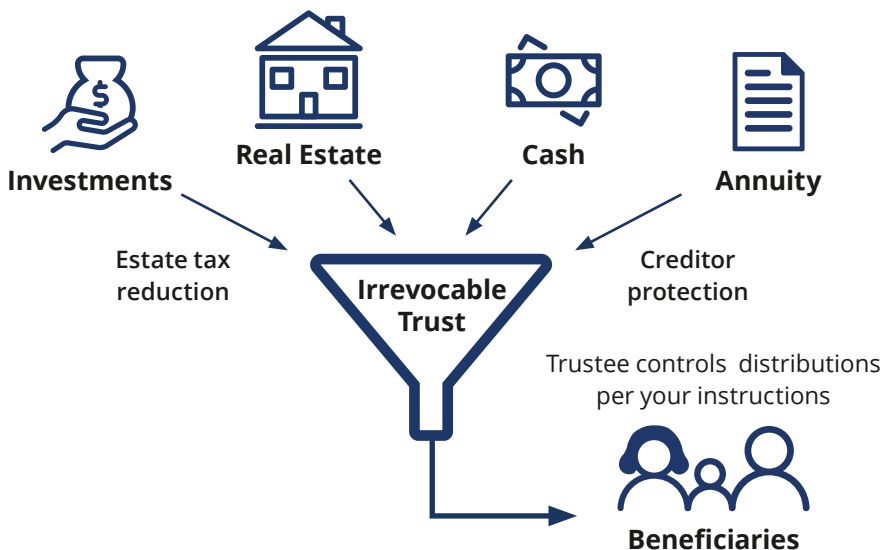
Sometimes it can be difficult to know whether an annuity contract fits the needs of the trust. For example, a trust might require preference given to income (current) beneficiaries over remainder beneficiaries. In this case it may be appropriate to set up one trust (or sub-trusts) for each beneficiary. This can help reduce or avoid conflicts between income and remainder beneficiaries and gives the trustee more flexibility when choosing a trust-owned annuity.

Why trust-owned annuities?

Certain types of annuities called “deferred” annuities offer the power of tax-deferred growth. Income earned in the annuity contract is typically not taxable until you access money in the contract. Funds continue to grow while delaying the impact of taxes.

Consider how tax deferral via trust-owned annuities can be a powerful benefit for non-grantor trusts. The trustee—faced with those harsh trust income tax brackets discussed above—can toggle income from the annuity on and off at appropriate times to effectively manage income needs and income taxes. This compares favorably to many other types of investments such as stocks and bonds where current income may be difficult to avoid. Further, variable annuities offer the opportunity for tax-free rebalancing as the market shifts, in addition to diversification through a variety of subaccounts offered in the annuity.

Also, remember the benefits of irrevocable trusts: estate tax reduction and enhanced creditor protection. When a trust-owned annuity is properly paired with an irrevocable trust, there are several key benefits. The annuity contract can offer the opportunity for diversification, income tax timing, tax-free rebalancing and tax deferral, while the irrevocable trust offers estate tax management and protection from creditors. All of these can work together to create a dynamic plan.



What about revocable living trusts?

Trust-owned annuities could also benefit grantor trusts. Even with the less harsh individual income tax rates, many wealthy grantors find themselves in the highest income tax brackets plus the 3.8% tax on net investment income. Managing taxable income can be a challenge, and tax deferral via the annuity contract can help.

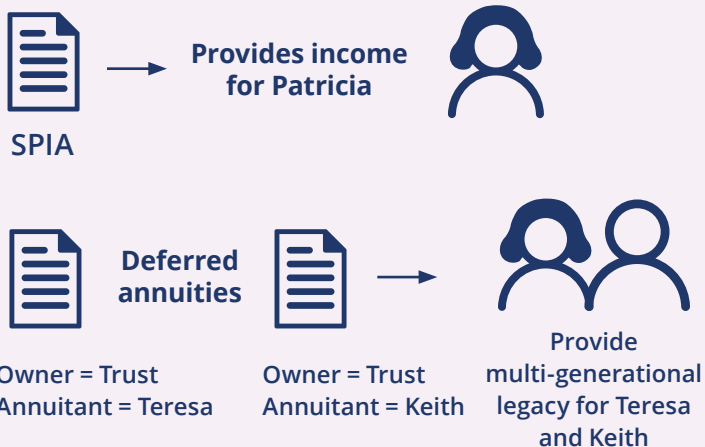
However, if you have a revocable living trust, in most cases, you will own your annuity contract individually (outside of the trust). You can simply name individuals or the trust as the *beneficiary* of your annuity. This still avoids probate and, if a trust is the beneficiary, can safeguard distributions for your heirs depending on how your trust is drafted. If a trust will be the beneficiary of your annuity, make sure to understand the payout options available with your contract and your annuity carrier. If you desire more flexibility should you become incapacitated during your lifetime, you might still consider listing your revocable trust as the owner of your annuity contract.

Case study

Several years ago, Charles (age 68) and Patricia (age 62) created a trust. At Charles' death, the trust created an irrevocable family trust known as a "credit shelter" trust. Patricia is the income beneficiary, and their two children, Teresa (age 34) and Keith (age 29), are the remainder beneficiaries. The trust creates two separate sub-trusts for Teresa and Keith.

The trustee purchases a single premium immediate annuity (SPIA) structured as a life annuity to benefit Patricia, the surviving spouse. This provides her with guaranteed annual income for her lifetime and protects her as the income beneficiary. The trust still has other assets to cover expenses and taxes in the trust.

The trustee also purchases two deferred annuity contracts for Teresa and Keith, the remainder beneficiaries. Teresa and Keith are the annuitant on two separate annuity contracts.



Planning consideration: Tax deferral

Trust-owned annuities do not automatically qualify for tax deferral. This is of paramount importance and requires careful analysis by your attorney and tax professional.

What is a Private Letter Ruling?

Much of the legal authority for trust-owned annuities is contained in 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.

A trust-owned annuity will generally qualify for tax deferral if the trust is acting as an “agent” for a natural person.¹ This typically means the trust is set up to benefit living, breathing individuals. All trust beneficiaries – including contingent beneficiaries – should be persons (not charities, family foundations or other entities). For example, if a charity is a beneficiary of the trust, the trust-owned annuity likely will not qualify for tax deferral and all growth inside the annuity will be taxed each year whether it is distributed from the annuity or not.

When the trust is a revocable grantor trust set up to benefit natural persons, a trust-owned annuity is likely to qualify for tax deferral. However, when the trust is irrevocable, the answer is less clear. Best practice based on IRS rulings known as Private Letter Rulings (PLRs) indicate the trust should be established for the sole benefit of a living, breathing beneficiary. The trust beneficiary will typically be the annuitant (the measuring life) of the annuity contract.

If the trustee decides to purchase trust-owned annuities for multiple beneficiaries, each trust beneficiary should typically be the annuitant on a separate annuity contract. As mentioned above, it can also be helpful to create separate trusts (or sub-trusts) for each beneficiary to help demonstrate the trust is acting as an agent for that beneficiary. In other words, using just one trust-owned annuity contract for multiple trust beneficiaries is generally not recommended.

Additionally, trustees of special needs trusts should be particularly careful when considering trust-owned, deferred annuities. Certain types of special needs trusts include a Medicaid pay-back provision. It is possible the IRS might view Medicaid or other state agency beneficiaries as non-natural person beneficiaries – said differently, that the trust would not be acting as an agent for a natural person – which could jeopardize the tax-deferral status of the trust-owned annuity contract. As a reminder, it is important to work with an attorney to discuss your situation.

At AuguStar, we require the trustee to sign a trust certification acknowledging their ability to seek independent tax advice regarding the trust-owned annuity contract and that AuguStar makes no representations or warranties regarding the tax treatment of the annuity.

What if I want to set up a charitable legacy?

Leaving a legacy for your favorite charity is a wonderful endeavor. But if your trust owns a deferred annuity contract, it’s best to make a separate charitable donation outside the trust. You could earmark other assets for your charity, name the charity the beneficiary of your life insurance or IRA, or even establish a charitable trust or family foundation.

¹ IRC Sec. 72(u). These rules apply to annuity contributions made after February 28, 1986.

Planning consideration: Navigating early withdrawal taxes

Another planning consideration is whether the trust-owned annuity will meet an exception to the 10% additional federal tax in the tax code.

Taxable amounts withdrawn² from a non-qualified annuity contract are generally subject to an additional 10% federal tax. This requires careful analysis to ensure your trust-owned annuity contract meets an exception, especially as amounts taken as a withdrawal from a non-qualified annuity contract are taxable as gain first.

There are several exceptions to the 10% additional federal tax, but the most common are generally based on:

Taxpayer's age: When distributions are made on or after the taxpayer attains age 59½;

Taxpayer's disability: When distributions are attributable to the taxpayer becoming disabled (as defined);

Taxpayer's life expectancy or joint life expectancy: Distributions are part of a series of substantially equal periodic payments (subject to strict rules); and

Holder's death: Distributions are made on or after the holder's death (or, where the holder is not an individual, upon death of the primary annuitant).³

One PLR indicated better treatment for grantor trusts than non-grantor trusts, holding that a non-grantor trust cannot qualify for an exception to the 10% additional federal tax (other than for death of the annuitant) because a non-grantor trust has no age, disability status, or life expectancy.⁴

Because of this, if current, guaranteed income is important, the trustee might consider a single premium immediate annuity (SPIA). Immediate annuities are exempt from both the 10% early withdrawal penalty and the non-natural person rules.⁵ In many cases, annuities are part of a well-balanced approach and will not be the only trust asset.

You should review these rules carefully with your attorney and tax professional.

² This rule applies to withdrawals – not amounts “annuitized” over life expectancy or a period of time.

³ IRC Sec 72(q)(2).

⁴ PLR 202031008.

⁵ IRC Sec. 72(q)(2)(I) and 72(u)(3)(E).

Planning consideration: in-kind distributions

If the trust has one grantor and the grantor passes away, the trust generally becomes an irrevocable trust, and the trust may no longer use the grantor's tax ID number. The trust becomes a non-grantor trust for income tax purposes.

If the annuitant is living and the trust allows, the annuity carrier might permit an in-kind distribution of the annuity to the annuitant. Practically, this is done through an annuity ownership change request form (it's easy to do). When the ownership change is made, the trustee is distributing the annuity contract to the annuitant. PLRs have blessed this strategy as a non-taxable event when the annuitant is the trust beneficiary.⁶ Income tax deferral continues until the beneficiary takes funds from the annuity. In other words, the income tax will be paid by the beneficiary when assets are actually taken from the annuity.

As mentioned above, in the case of multiple beneficiaries, each trust beneficiary should be the annuitant of a separate annuity contract, and separate trusts (or sub-trusts) are often used. In any case, your attorney should carefully draft the trust to align with the facts in favorable PLRs. This allows the trust beneficiary/annuitant to continue the contract free and clear of the trust, and it allows the annuity contract to continue to grow on a tax-deferred basis.

⁶ PLRs 199905015 and 201124008.

Alternatively, if the grantor is the annuitant and has passed away with the trust as owner and beneficiary of the annuity, you should consult the carrier to determine what happens. The contract may be in payout mode, and there are typically a limited number of payout options. The trustee may be able to elect spousal continuation (if the spouse is the sole income and primary trust beneficiary) or “stretch” the annuity payout over the life expectancy of the oldest trust beneficiary (for non-spouse beneficiaries).

Annuity carriers differ on what they will allow. It’s best to familiarize yourself with the trust payout options available in your annuity contract. AuguStar is equipped to assist with this strategy.

Case study

Let’s continue the previous example. You’ll recall that when Charles passed, a credit shelter trust was formed. Patricia is the income beneficiary, and Teresa and Keith are the remainder beneficiaries. The trust has two separate sub-trusts – one for each remainder beneficiary.

In addition to a SPIA for Patricia, the trustee also purchases two deferred annuity contracts for Teresa and Keith, the remainder beneficiaries.

Importantly, the annuity carrier permits in-kind distributions based on PLRs. Teresa and Keith are the annuitants on two separate annuity contracts (one for each sub-trust).

Owner = Trust
Annuitant = Keith



Deferred
annuities



Owner = Trust
Annuitant = Teresa

When Patricia passes, the trustee will submit an ownership change request form, distributing the annuity contracts to Teresa and Keith, respectively. It can be a non-taxable event based on PLRs.

The annuity contracts continue to grow on a tax-deferred basis for Teresa and Keith, and gains are not taxable until Teresa and Keith take funds from the annuity.

This powerful planning technique saves estate and transfer taxes (via the irrevocable trust) and helps Teresa and Keith establish their own retirement savings and long-term legacy planning on a tax-deferred basis.

Owner = Keith
Annuitant = Keith



Deferred
annuities



Owner = Teresa
Annuitant = Teresa

Key takeaways for a dynamic plan

Trust-owned annuities can be a powerful planning tool. Understanding the rules can help navigate how and when to use trust-owned annuities.

Understand your trust document. Familiarize yourself with whether your trust is revocable or irrevocable, grantor or non-grantor, etc., and whether it authorizes your trustee to purchase annuity contracts. Your AuguStar financial professional can request a free document review of your trust through AuguStar's Advanced Planning Team to help you better understand your estate plan.

Trust-owned annuities are powerful in the right situation. For many individuals, an irrevocable trust strategy might not be a fit. Generally, trust-owned annuities tend to make the most sense for individuals with sizeable estates, a potential state estate or inheritance tax problem, and/or creditor protection concerns. When they do fit, trust-owned annuities can be a powerful, multi-generational legacy tool.

One annuity contract per beneficiary. If you are interested in the in-kind distribution strategy and your trust has multiple beneficiaries, best practice suggests purchasing a separate annuity contract for each trust beneficiary. Each trust beneficiary should be the annuitant of a separate annuity contract. Additionally, your attorney should carefully draft the trust to align with the facts in favorable PLRs.

Carefully consider charitable beneficiaries. Leaving a legacy for charity is a wonderful endeavor. But when it comes to trust-owned annuities, consider separating your charitable legacy from deferred, trust-owned annuities. For example, you might consider these strategies:

- Naming a charity the beneficiary of your life insurance policy or IRA;
- Setting up a separate trust to benefit your favorite charity (such as a charitable remainder trust);
- Earmarking other assets or accounts outside of the trust for charitable purposes; or
- Establishing a family foundation.

Don't go it alone. These strategies are complex. Work closely with your tax and legal professionals when considering and implementing a trust-owned annuity.



Take the next step

Working with your financial professional to develop the right plan is crucial to achieving your estate planning goals. An AuguStar trust-owned annuity may be able to help you achieve those goals.

Talk to your financial professional today.

Early withdrawals or surrenders may be subject to surrender charges. Withdrawals are also subject to ordinary income tax and, if taken prior to age 59½, an additional 10% federal tax may apply. Tax rules require that withdrawals be taken first from any unrealized gain in the contract. Federal and state tax laws applicable to this product are subject to change.

This guide generally applies to annuity contracts issued after April 22, 1987. In the 1980s, massive changes were made to the tax code impacting how annuity contracts are taxed. Some of the rules mentioned in this guide have dates applicable even earlier than April 22, 1987. If you have an annuity contract issued during or before this time, consult your tax professional to discuss.

This guide 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.

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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