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Advanced Markets Matters

Annuities in Trusts
Trust Worthy for Wealth Goals

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Agenda

- Annuity basics
- Trust basics
- Interest of trustees in nonqualified annuities
- Grantor vs. non-grantor trusts
- Taxation of annuities in trusts
- Entity ownership certificate
- Uses of annuities in trusts

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Annuity Basics

- Classified according to:
  - Immediate or deferred
  - Single premium or flexible premium
  - Fixed, fixed indexed, or variable
- Taxation
  - Exclusion ratio for immediate annuities
  - Tax deferral for deferred annuities
  - Payments not received as an annuity taxed under LIFO taxation
- Intended as long-term investment, generally for retirement
  - 10% early distribution penalty
  - Required distributions under 72(s) upon death of holder/owner

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Annuity Basics

- Required distributions upon death

Spouse	Non-Spouse
Continue contract and step into shoes of owner	Death before annuity starting date (ASD) – 5 years or over life expectancy of beneficiary
	Death after ASD – over owner's remaining life expectancy or life expectancy of beneficiary

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Trust Basics – Role of Trustee

- Hold, manage and care for trust property as a fiduciary
- Make prudent investment decisions
- Provide accounting of trust income, distributions and expenditures
- Understand taxation of trust property and possibly file annual tax returns for trust

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Trust Basics – Investment Options for Trustees

- What kind of property?
  - Personal residence
  - Closely held business
  - Any investment property
    - stocks or bonds
    - life insurance and annuities
    - cash

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Trust Basics – Investment Options for Trustees

- What can trustees invest in?
  - Generally broad powers to invest
  - Powers/instructions listed in trust document
  - State trust law

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Interest of Trustees in Nonqualified Annuities

- Advantages
  - Tax deferral
  - Distribution control
  - Guarantees offered by riders
  - Lack of underwriting
- Disadvantages
  - Expenses
  - Limited deferral on death of annuitant
  - Early distribution penalty
  - Tax uncertainty

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Grantor vs. Non-Grantor Trusts

Revocable/Living Trusts
Grantor retains power and control
Grantor taxed on income
Assets remain in the grantor's estate

Revocable Trust = Grantor Trust

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Grantor vs. Non-Grantor Trusts

Irrevocable Trusts
Grantor relinquishes control and cannot revoke
Trust taxed on income
Assets removed from the grantor's estate

In the past ...
Irrevocable Trust = Non-Grantor Trust

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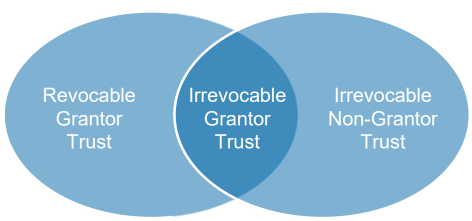
Intentionally Defective Grantor Trust (IDGT)

- Irrevocable – removes assets from client's estate
- Income taxed to grantor
- Requires own tax ID – special rules for reporting income and expenses



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Taxation of Annuities in Trust

- Tax deferral
  - Must be held as an agent for a natural person
  - Generally, all beneficiaries of trust must be natural persons
  - Compressed income tax brackets for irrevocable non-grantor trusts

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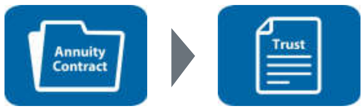
Taxation of Annuities in Trust

- Transfers to trusts



Nontaxable	Taxable
Grantor to revocable trust	Grantor to irrevocable non-grantor trust
Grantor to irrevocable grantor trust	

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Taxation of Annuities in Trust

- Trust-owned annuity contract at death
  - Annuitant is measuring life
  - Trust must be beneficiary
- Required distributions under Section 72(s)
  - Holder deemed to be primary annuitant
  - Death of annuitant triggers required distributions
  - Beneficiary is not a natural person
  - No nonqualified stretch – deferral limited to 5 years

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Taxation of Annuities in Trust

- In-kind distribution (before death of annuitant)

Nontaxable	Taxable
From non-grantor trust to beneficiary	From grantor trust to beneficiary (other than the grantor)

*Based on several private letter rulings. It should be noted that private letter rulings have no reliance value other than for the particular taxpayer receiving the ruling.

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Taxation at a Glance

Grantor Trusts	Irrevocable Non-Grantor Trusts
Grantor may or may not have relinquished right to modify or revoke trust	Grantor relinquishes right to modify or revoke trust
Grantor treated as owner of trust for income tax purposes – income subject to tax at grantor's tax rates	Income subject to tax at higher trust tax rates
Transfer from grantor of annuity to trust is a **nontaxable** event	Transfer from grantor to trust is a **taxable** event
In-kind transfer of annuity contract is a **taxable** event (unless to grantor)	In-kind transfer of annuity contract is a **nontaxable** event

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Entity Ownership Certificate

- Must be submitted with application
  - Indicate whether the trust is revocable or irrevocable
  - Have the requisite signatures regarding trust certification and indemnification
- Additional documents required
  - A copy of the first page of trust
  - All pages naming trustees and successor trustees
  - The signature page of trust

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Entity Ownership Certificate

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Living Trust Scenario

Purpose
Provide asset management in the event of incapacity, avoid probate, and ensure privacy

Type
Grantor Trust

Product
Deferred annuity

Opportunity
Purchase for same reasons as any individual – tax deferral, protected lifetime income, risk management

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Credit Shelter Trust Scenario

- Holds assets equal to the federal estate tax exemption amount ($11.7M in 2021) upon the death of the first spouse
  - Income for the surviving spouse
  - Maintain trust assets for remainder beneficiaries (children of the married couple or children from a previous marriage)
  - Prevent surviving spouse from having full control of the assets and having assets includable at surviving spouse's death

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Credit Shelter Trust Scenario

Purpose
Ensure assets remain for benefit of children, shelter appreciation of assets, provide creditor protection and/or permit professional management

Type
Irrevocable Non-grantor Trust

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Credit Shelter Trust Scenario

Goal
Provide income to surviving spouse while maintaining trust assets for children

Product
Single Premium Immediate Annuity (SPIA)

Opportunity
Address income need and allow trustee to focus on investing other assets for growth for children

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Credit Shelter Trust Scenario

- Irrevocable non-grantor trust taxed at trust rates

Marginal Rate	Married Filing Joint (2021)	Estates & Trusts (2021)
10%	0–$19,900	0–$2,650
12%	$19,901–$81,050	
22%	$80,051–$172,750	
24%	$172,751–$329,850	$2,651–$9,550
32%	$329,851–$418,850	
35%	$418,851–$628,300	$9,551–$13,050
37%	Over $628,300	Over $13,050

*Reflects 2021 tax rates.

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Credit Shelter Trust Scenario

Goal
Grow assets for benefit of children

Product
Single Premium Deferred Annuity (SPDA)

Opportunity
Tax deferral of SPDA allows assets to grow without current taxation at higher trust tax rates and provides certain guarantees

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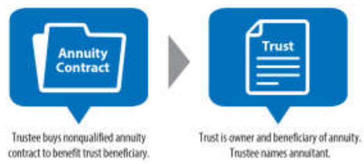
Credit Shelter Case Study: Creating a Legacy

- The Westons
  - Robert and Ann
  - Wish to leave a legacy for their two children, Jon and Julie
  - Establish a credit shelter trust
- Upon Robert's death, trust was funded with $6M



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Credit Shelter Case Study: Creating a Legacy

- Purchase one nonqualified deferred annuity for $1M with Ann as the annuitant

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Credit Shelter Case Study: Creating a Legacy

- Purchase two nonqualified deferred annuities for $500K each
  - Jon named as annuitant on one
  - Julie named as annuitant on the other

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No Trust Scenario

Goal
Control distributions to beneficiaries without expense of trust

Product
Nonqualified Deferred Annuity

Opportunity
Use of Beneficiary Form to restrict beneficiaries' spending of their inheritance

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No Trust Scenario

- Options*
  - Full restriction
    - Life annuity
    - Life annuity with period certain
    - Period certain
  - Partial restriction (determined by percentage or dollar amount)

*Subject to contract availability.

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Case Study: Protecting a Legacy

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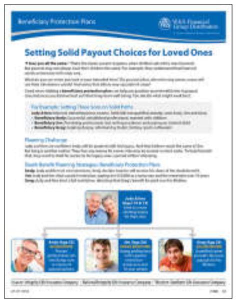
No Trust Scenario



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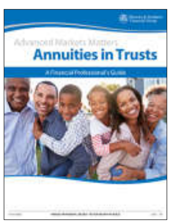
Annuities in Trust: Resources for You



Annuities in Trusts: Client Overview (CF-70-40000)

Creating a Legacy: Case Study (CF-70-40002)

Annuities in Trusts: 7 Key Points (CF-70-40001)

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Generational Wealth
Annuities in Trusts

An Overview

Annuities in Trusts: Expanding Opportunity

Are You Ready to Talk Annuities in Trusts?

All the traditional advantages of nonqualified annuities, plus added ones provided by today's new features, are attracting attention from trustees. Decision makers overseeing various types of trusts are ready to talk. Are you?

Annuity Opportunities

You may already know the benefits commonly offered by individually owned nonqualified annuities:

- Income tax deferral
- Protected lifetime income
- Risk management
- Guaranteed rate options
- Living benefits
- Enhanced death benefit riders
- Access to funds (within limits)
- Exemption from probate

Trust Opportunities

You may not be as familiar with the potential benefits of trusts. These vary by trust type and local laws. They generally include:

- Maximum flexibility in distribution of assets
- Management of trust assets in case of incapacity
- Protection from creditors
- Exemption from probate
- Possible reduction of estate and gift tax

Combining the Opportunities

Utilizing annuities in trusts can leverage the benefits of both. It can provide sound investment options and innovative planning strategies. Read on to consider more information about this concept. Enhance your ability to weigh some of the potential pros and cons of using an annuity in a trust as a multi-generation wealth preservation tool.

Understanding Trusts: Know the Basics

A **trust** is a fiduciary relationship. One person holds property for the benefit of another person. The **grantor** creates the trust. The grantor executes a trust document and transfers property to the trust. The **trustee** administers the trust according to the terms of the trust document. The trustee does so for the benefit of the **beneficiary**. The property held in trust is the **trust corpus** or **res**.

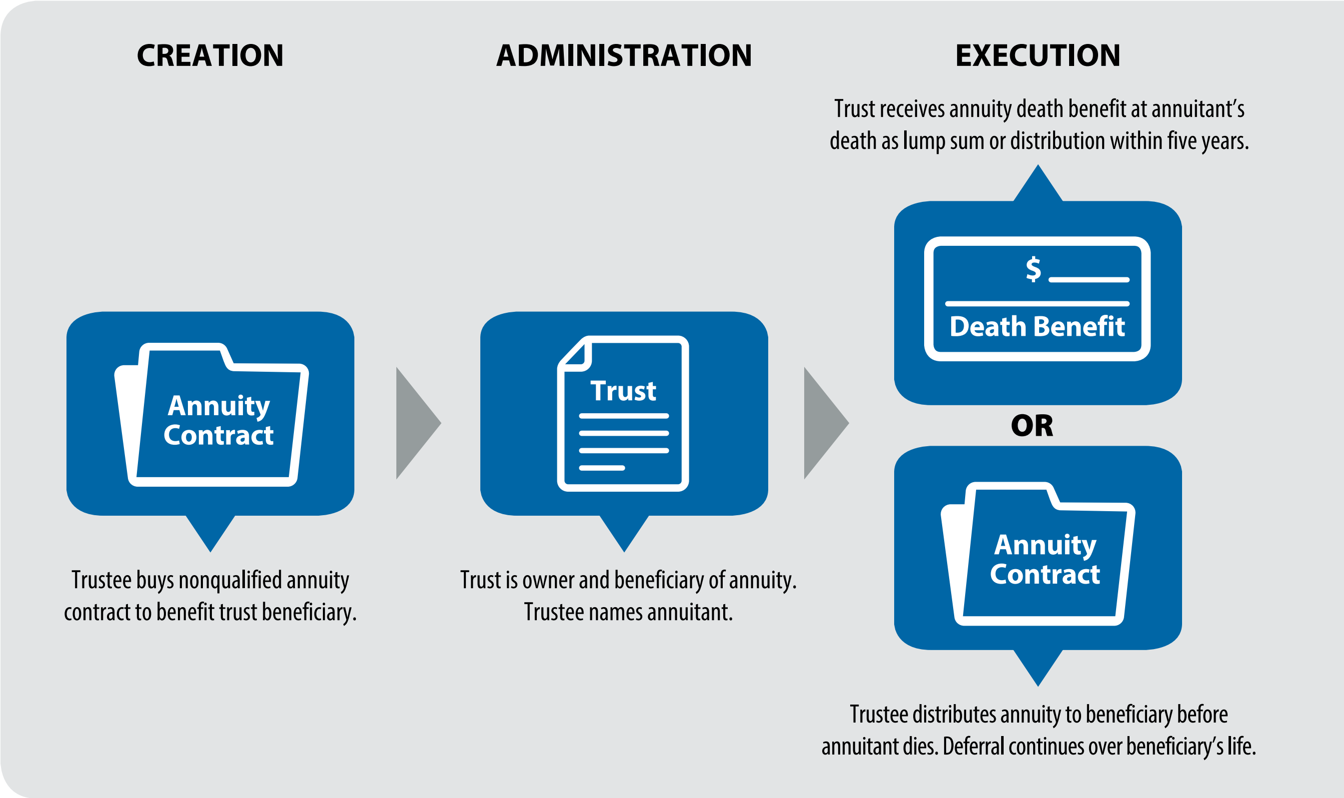
State law controls the creation, operation and termination of a trust.

The grantor may create the trust during their lifetime (an **inter vivos** trust) or by will at death (a **testamentary** trust). Almost any property can be placed in trust. Examples include a personal residence, a closely held business and assets such as stocks, bonds, life insurance, annuities and cash. The trustee receives legal title to the property held in trust.

A grantor who retains the right to revoke or modify the trust creates a **revocable** trust. For income tax purposes, the grantor is treated as the owner of the trust and is taxed on trust income. A revocable trust does not remove the assets in the trust from the grantor's estate.

Alternately, a grantor who relinquishes the right to amend, modify, change or revoke the trust creates an **irrevocable** trust. Property placed in a carefully drafted irrevocable trust is removed from the grantor's estate — and placed beyond the reach of creditors and judgments.

How Does It Work?



Annuities in Trusts: Some Tax Considerations

Tax Deferral and Tax Rates

Annuity contracts owned by trusts that merely hold the annuity contract as an agent for a natural person – i.e., all the beneficiaries are natural persons – are generally treated as annuity contracts for income tax purposes. Thus, income earned on the nonqualified annuity contract each year is not subject to current income tax or to the additional 3.8% net investment income tax.

Taxable income retained by non-grantor irrevocable trusts is subject to comparatively higher trust income tax rates. These trusts reach the highest income tax rate (37%) at $12,751 of taxable income (in 2019). In comparison, married couples filing jointly do not reach the 37% income tax rate until $612,351 of taxable income (in 2019).

Tax Brackets for 2019

Marginal Rate	Married Filing Joint	Estates & Trusts
10%	0–$19,400	0–$2,600
12%	$19,401–$78,950	
22%	$78,951–$168,400	
24%	$168,401–$321,450	$2,601–$9,300
32%	$321,451–$408,200	
35%	$408,201–$612,350	$9,301–$12,750
37%	Over $612,350	Over $12,750

Control over Recognition of Income

In addition, the undistributed gains inside an annuity are not generally defined as trust income under most state trust laws. Accordingly, they do not have to be distributed to current income beneficiaries. This provides trustees with flexibility. They can request distributions only as needed.

Required Distributions at Death

Certain distributions are required upon the death of the holder of a nonqualified annuity contract. If a required distribution is not made, the contract will not be treated as an annuity contract for income tax purposes under IRC Section 72(s).

Key points regarding required distributions at death include:

- Generally, if the holder of the annuity contract dies *before* the annuity starting date, the entire interest must be distributed within five years of the holder's death or over the life or life expectancy of a designated beneficiary.
- If the holder of the annuity contract dies after the annuity starting date, the interest must be distributed as least as rapidly as under the method used by the holder or over the life or life expectancy of a designated beneficiary.
- When an annuity is owned by a non-natural person (such as a trust), the *holder* of the annuity is deemed to be the primary annuitant. Thus, the death of the annuitant will trigger required distributions under IRC Section 72(s).

Any trust that owns a nonqualified annuity issued by Integrity Life Insurance Company or National Integrity Life Insurance Company must also be named as the annuity beneficiary of that contract. Because a trust is a non-natural person beneficiary, the longest period of time that the annuity death benefit payout can be deferred is five years from the annuitant's date of death.

Transfer of an Annuity to a Trust

IRC Section 72 (e)(4)(c) requires that an owner who transfers an annuity for less than full and adequate consideration count as income any gain on the contract at the time of the transfer. So the type of trust – revocable or irrevocable – receiving the transfer is a key distinction:

- When an annuity is transferred to a **grantor trust (whether revocable or irrevocable)**, the annuity is not treated as being transferred for income, estate or gift tax purposes. Why? Because there is no transfer. *Ownership* of the annuity remains the same before and after the transfer.
- When an annuity is transferred to a **non-grantor irrevocable trust**, ownership has changed. The transfer will trigger recognition of all gain on the contract at the time of the transfer.

In-Kind Distribution

The transfer of an annuity contract in kind from a properly structured trust to a beneficiary is not a taxable event. In several private letter rulings the Internal Revenue Service has stated that the distribution of an annuity contract from a non-grantor trust to a trust beneficiary does not constitute a transfer without full and adequate consideration under IRC Section 72(e)(4)(c).* This holds because the trust, in each of these cases, was not an individual for purposes of that section. The trust beneficiary simply becomes the owner of the contract and assumes the trust's cost basis in the annuity. Tax deferral continues for the new owner. The new owner can name a designated beneficiary to continue the deferral for as long as permitted.

Annuities in Trusts: Taxation At-A-Glance

Grantor (Revocable or Irrevocable) Trust	Non-Grantor Irrevocable Trust
Treated as owner of trust for income tax purposes — income subject to tax at grantor's tax rates using grantor's Taxpayer Identification Number (TIN)	Income subject to tax at higher trust tax rates — trust must have its own TIN
Does not remove assets from grantor's estate	Removes assets and appreciation from grantor's estate
Transfer of annuity to trust is nontaxable	Transfer from grantor to trust is a taxable event
In-kind transfer of annuity contract from trust to any beneficiary is a taxable event (unless to grantor)	In-kind transfer of annuity contract from trust to beneficiary is nontaxable event

*PLRs 201124008 and 199905015. A private letter ruling has no reliance value other than for the particular taxpayer receiving the ruling.

Selected Types of Trusts: Quick Reference

	Revocable Trust	Credit Shelter Trust (CST)	Charitable Remainder Trust (CRT)
Description	Created during life and can be changed or revoked at any time prior to grantor's death or incapacity. Becomes irrevocable upon the grantor's death.	Created to hold assets equal to the federal estate tax exemption amount in trust upon the death of the first spouse. May provide income for the surviving spouse while maintaining trust assets for remainder beneficiaries (children of the married couple or children from a previous marriage) and preventing surviving spouse from having full control of the assets.	Designed to split gifts between a charity and a non-charitable beneficiary.
Purpose	Provide asset management in the event of incapacity, avoid probate, ensure privacy and avoid ancillary administration of assets held in other states.	Ensure couples likely to be subject to estate tax can take advantage of the federal estate tax exemption amount. Could have been established prior to availability of portability or after to ensure assets remain for benefit of children, shelter appreciation of assets, provide creditor protection and/or permit professional management.	Donate appreciated assets with low basis without incurring capital gain taxes while enjoying other tax benefits, receiving an income stream for a term of years or for life and benefiting a charity.
Tax Implications	Grantor is treated as the owner of the trust and all income of the trust is taxed to the grantor at the grantor's tax rate. Transfer of property to the trust does not result in gift tax. Property in trust is includable in the grantor's estate.	Assets placed in trust, and all appreciation, are removed from the estate of the surviving spouse upon the death of the surviving spouse.	Donor avoids capital gain taxes, receives charitable income tax deduction and removes asset from donor's estate. CRT does not qualify as an agent for a non-natural person and does not receive nor need the annuity's tax deferral. Trust ownership of annuity does not disqualify its status as a CRT.
Use of Annuity	Even though annuity contracts already provide some benefits similar to those provided by a revocable trust, such as probate avoidance, there may be other valid planning reasons for a revocable trust to be the owner. Thus, trustees may purchase an annuity for any of the reasons an individual would — tax deferral, protected lifetime income, risk management or protection from creditors.	A single premium immediate annuity (SPIA) may be an appropriate financial vehicle for paying annual income to the trust's income beneficiary (surviving spouse) and allowing the trustee to concentrate on investing the other assets for growth for remainder beneficiaries (children). The trustee may purchase a deferred annuity with the surviving spouse as annuitant for liquidity at the surviving spouse's death or purchase a deferred annuity for each remainder beneficiary as the annuitant of his or her own annuity with the intent to distribute the annuity contracts at the death of the surviving spouse.	Trustee may consider an annuity for reasons such as guarantees, rider benefits, and income accounting rules. In most states, undistributed gains inside an annuity are not defined as trust income and need not be distributed currently to the income beneficiary. Especially with a net income make-up charitable remainder unitrust (NIMCRUT) – a CRT that need only distribute income actually earned as opposed to having to distribute the required payout each year – the nonrecognition of income can allow a trustee to accumulate more for later distribution (usually as donor nears retirement age).

Annuities in Trusts: Consider the Opportunity

Trusts holding today's nonqualified annuities may offer significant tax, spendthrift, diversification and income protection opportunities. Careful structuring of the deferred annuity contract is essential to obtaining the desired tax and beneficiary result.

It is critical to understand that annuities may not be appropriate for all types of trusts. Factors such as the purpose of the trust, the terms of the trust and the controlling state law must guide the decision making.

Considering a wide range of alternatives is a prudent starting point. And annuities in trusts can be one of those alternatives of value.

Administering a trust is a complex process. First and foremost, seek the assistance of an attorney and a tax professional.

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Interest rates are declared by the insurance company at annual effective rates, taking into account daily compounding of interest. Riders are optional and contain additional cost. Diversification may not protect against market risk.

Payment of benefits under the annuity contract is the obligation of, and is guaranteed by, the insurance company issuing the annuity. Guarantees are based on the claims-paying ability of the insurer. Product approval, availability and features may vary by state. Earnings and pre-tax payments are subject to income tax at withdrawal. Withdrawals prior to age 59½ are generally subject to a 10% IRS penalty tax.

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Annuities in Trusts

Creating a Legacy: A Case Study

Identify Client Objectives

Meet Ann Weston and her two children, Jon and Julie. Jon is the son of Ann's second husband, Robert, and his first wife. Julie is the daughter of Ann and her first husband. Prior to Robert's death in 2017, Ann and Robert often talked about leaving a financial legacy for the children. Both wanted to make sure that his or her own child would inherit an equal share. Part of Robert's estate plan involved establishing a credit shelter trust upon his death to:

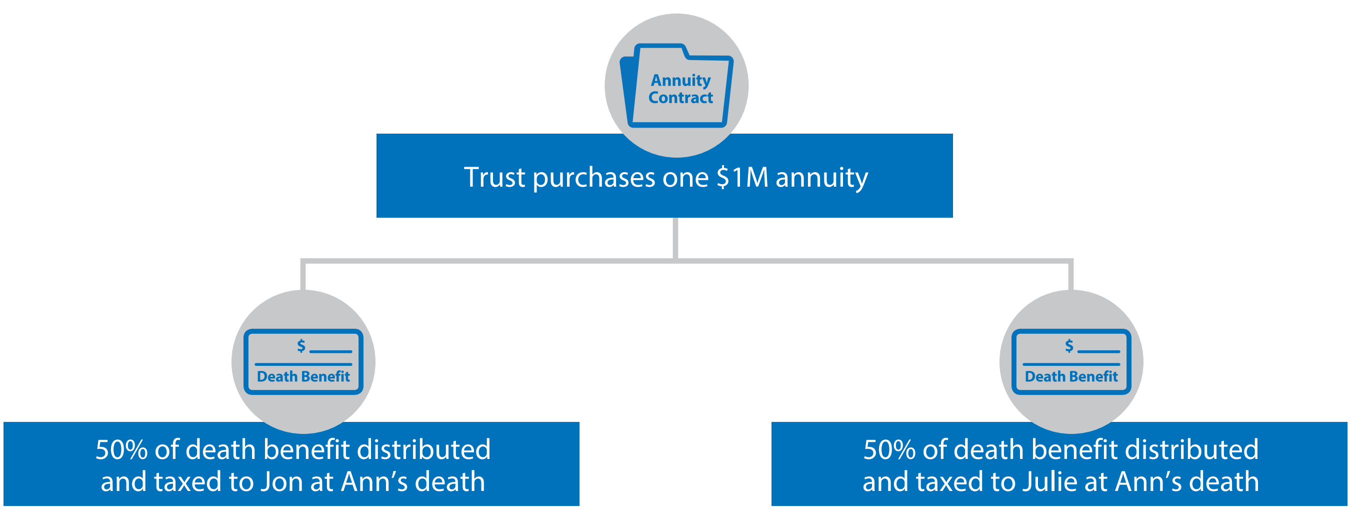
- provide income for his surviving spouse Ann (income beneficiary)
- maintain trust assets for his children (remainder beneficiaries)
- if necessary, minimize estate taxes by maximizing his estate tax exemption ($5.49 million in the year of death; $11.4 million in 2019; and reverting to $5 million – as indexed for intervening years – in 2026)

Upon Robert's death, the trust was funded with $5.49 million in cash and other property. At a recent meeting, the trustee discusses with Ann the possibility of investing a portion of the assets in a nonqualified annuity. The trustee explains that the growth within a nonqualified annuity contract accumulates tax-free and would not be subject to the higher trust income taxes or the additional 3.8% net investment income tax; thus, the money that would otherwise go to pay taxes continues to work for her. The decision is made to invest $1 million in a nonqualified tax-deferred annuity. The trust will be the owner and beneficiary of the contract.

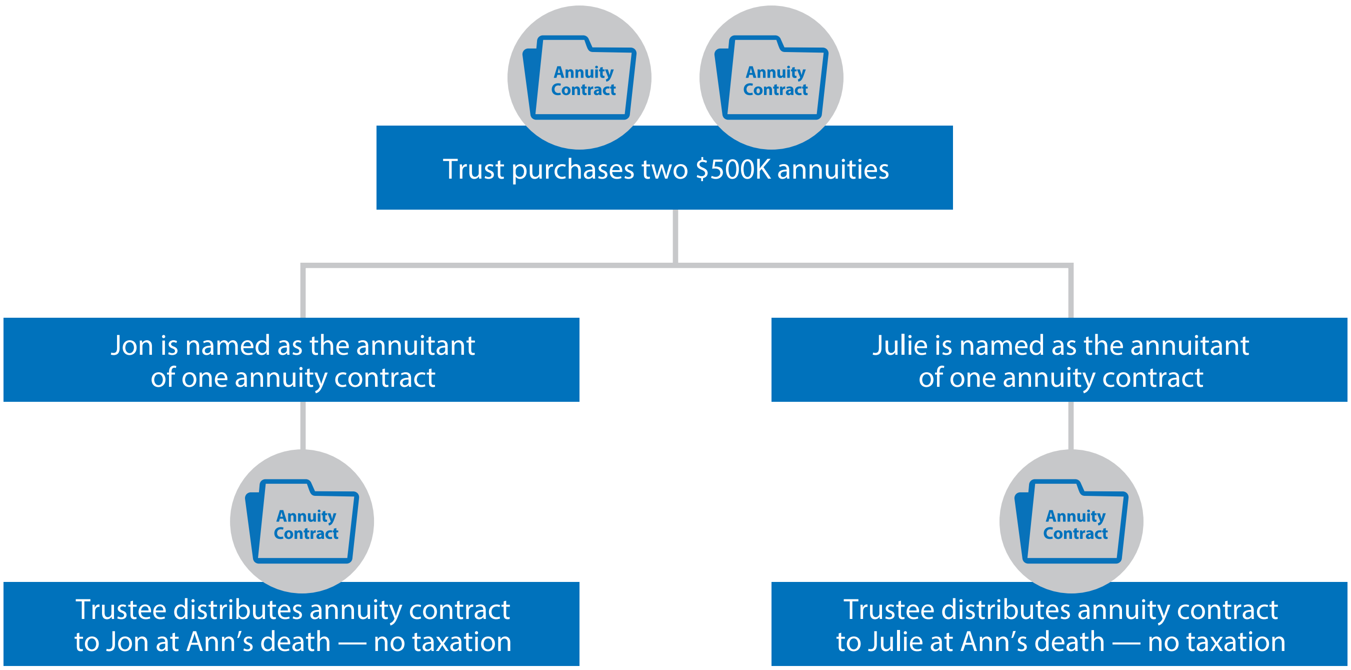
Consider Structuring Options

The next step to consider is who to designate as the annuitant:

Purchase one nonqualified annuity for $1 million with Ann as the annuitant. The death benefit will be paid on her death and must be distributed in a lump sum or over a period of no longer than five years. Distribution will be a taxable event to the trust (if retained) or to the children (if distributed).



Purchase two annuities for $500,000 each with Jon named as the annuitant of one and Julie named as the annuitant of the other. At the death of Ann, the trustee can choose to distribute the annuities to the respective annuitants. This is not a taxable event.* Jon and Julie simply become the owner of their own contract. Each then can name a designated beneficiary. Jon and Julie each assumes the cost basis of the trust in their own nonqualified annuity and can continue the tax deferral.



Establish a Lasting Legacy

The decision to go with two separate nonqualified deferred annuity contracts with the children as the annuitants has the added benefit of allowing even further tax deferral and truly delivering on Robert's and Ann's wish to provide a financial legacy. Looking far ahead, upon the passing of the children someday, their designated beneficiaries can elect to stretch the tax deferral over their lifetimes.

Need help talking about trusts? Contact us. Or visit WSFinancialPartners.com

*While the distribution is tax neutral, there may be negative non-tax consequences, such as the termination of optional benefits and riders upon a change in ownership.

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Setting Solid Payout Choices for Loved Ones

"I love you all the same." That's the classic parent response when children ask who's most favored. But parents may not always *trust* their children the same. For example, they understand that financial needs and money skills may vary.

What do you see when you look at your intended heirs? Do you trust that, when the day comes, some will use their inheritance wisely? And worry that others may squander it away?

A **beneficiary protection plan** using a nonqualified annuity can help you position your beneficiaries in payout circumstances you believe best suit their long-term well-being. You decide what might work best.

For Example: Setting Three Sons on Solid Paths

Judy & Ken: Married, retired business owners, $600,000 nonqualified annuity, sons Andy, Jim and Greg

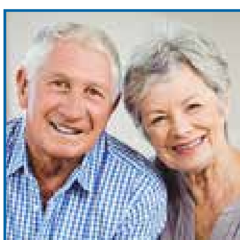
- **Beneficiary Andy:** Successful, established professional, married with children
- **Beneficiary Jim:** Promising professional, but renting residence and paying on student debt
- **Beneficiary Greg:** Aspiring deejay, informal day trader, fantasy sports enthusiast

Planning Challenge

Judy and Ken are confident Andy will be prudent with his legacy. And they believe much the same of Jim. But Greg is another matter. They fear any money he comes into may be wasted in short order. To help forestall that, they want to limit his access to his legacy over a period of their choosing.

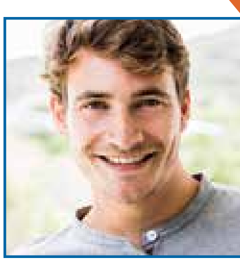
Death Benefit Planning Strategies: Customized Beneficiary Protection Plans

Andy: Judy and Ken set no restrictions. Andy decides how he will receive his share of the death benefit.
Jim: Judy and Ken elect a partial restriction, paying Jim $10,000 as a lump sum and the remainder over 10 years.
Greg: Judy and Ken elect a full restriction, directing that Greg's benefit be paid over his lifetime.

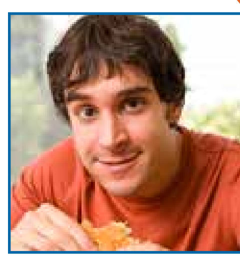


Judy & Ken (Ages 70 & 72)
Seek to create a lasting legacy for their sons

Andy (Age 35)
NO RESTRICTION
Proven professional; can elect lump sum or choice of payout options



Jim (Age 30)
PARTIAL RESTRICTION
Young professional with a partial restriction – lump sum and 10-year certain



Greg (Age 25)
FULL RESTRICTION
Unsettled career pursuits; Receives payouts for his lifetime

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Three Avenues of Payout Control for Nonqualified Annuities

- No Restriction
- Partial Restriction
- Full Restriction

Who Can Benefit and How

A customized beneficiary protection plan allows you to structure multiple payments, income for a specific period or lifetime income to your designated beneficiaries for special needs that may arise. A plan can help:

- Insure the education of a grandchild
- Support a child struggling in a new career or business venture
- Assist beneficiaries who have difficulty managing money
- Promote a multi-generation legacy of financial prudence securing hard-earned family wealth

What's more, you decide who receives payments, how often, how long and the payment structure.* Payments are flexible and can be made to one or multiple beneficiaries. For example, you can elect a lump sum payment to one beneficiary and a guaranteed stream of payouts to another. Payouts can be made monthly, quarterly, semi-annually or annually. Payouts can also be structured to be an initial lump sum followed by a guaranteed series of payouts. You decide what makes the most sense for your situation.

Beneficiary Protection Plans for Nonqualified Annuities: Potential Advantages

- Allows you to customize your legacy
- Restricts beneficiaries' access to your annuity proceeds (spouses excluded)
- Enables beneficiary restrictions without the expense of a trust
- Creates lifetime benefit possibilities
- Permits restrictions to vary by beneficiary
- Extends time for potential tax-deferred compounding of annuity assets
- Utilizes exclusion ratio on nonqualified contracts — each scheduled payout is part nontaxable return of premium paid into the annuity and part taxable gain earned by the annuity during its accumulation phase

Learn more about Beneficiary Protection Plans. Contact your financial professional.

Limited Options for Qualified Assets

Beneficiary distribution restrictions placed on qualified contracts must meet the new RMD requirements imposed by the SECURE Act. For non-spouse beneficiaries, in most cases, the entire death benefit must be distributed by the end of the 10th year after the contract owner's death.

*Payout options differ by product. All options may not be available.