Annities in Trusts
Creating a Legacy: A Case Study

Identify Client Objectives
Meet the Westons: Ann and Robert and their children, Jon and Julie. Over the years, Ann and Robert often talked about leaving a financial legacy for their heirs. Part of Robert’s estate plan involved establishing a credit shelter trust upon his death to:

- minimize estate taxes by maximizing his estate tax exemption ($5.49 million in 2017)
- provide income for his surviving spouse Ann (income beneficiary) and
- maintain trust assets for his children (remainder beneficiaries).

Upon Robert’s death, the trust is funded with $5.49 million in cash and other property. 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).

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(continued)
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.

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* 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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