ADVANCED STRATEGIES

Power planning:

The multigenerational benefits of trust-owned annuities

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Putting the benefits of an annuity to work for a trust

Today's global economy and volatile markets create challenges for trustees who are tasked with driving growth, preserving capital, and managing the ever-present sting of taxes and expenses in trust-owned portfolios.

Did you know that trusts can benefit from the same features that individuals find in annuities? Namely, tax deferral,* income control, and diversified investment options.

On the next few pages, we're going to walk through three phases of trust planning (accumulation, distribution, and post-death planning) and show the many ways that a trust-owned annuity can be a powerful planning tool.

Annuities are long-term, tax-deferred vehicles designed for retirement. Variable annuities involve risks and may lose value. Earnings are taxable as ordinary income when distributed. Individuals may be subject to a 10% additional tax if withdrawn before age 59½ unless an exception to the tax is met.

* Tax deferral offers no additional value if an IRA or a qualified plan, such as a 401(k), is used to fund an annuity. It also may not be available if the annuity is owned by a legal entity such as a corporation or certain types of trusts.

Wealth transfer through the generations

ALL IN THE FAMILY: THE BENSON CASE STUDY

Meet Jeff and Kim Benson, a hard-working couple from Arizona. Kim is the CEO of a local hospital and Jeff is a pharmacist. They both value education, enjoy traveling, and are patrons of the arts in their community. The couple has three children (Daniel, Matt, and Kate), and they want to make sure their children and grandchildren one day have the financial opportunities that they themselves enjoy. To help in this endeavor, they meet with their attorney and create an estate plan that includes a will and a trust.

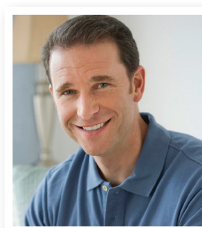
Many trusts are set up to benefit two types of individuals: the income beneficiary who receives income from the trust and the remainder beneficiaries who receive assets at some point in the future. Kim and Jeff's goal for setting up the trust is to maximize wealth transfer and minimize taxation for their children.

In this case study, you'll see how trust proceeds are used to fund a $1 million annuity that allows tax deferral to continue to three generations, benefiting Jeff and Kim's children and creating the potential for a $20,164,861 legacy for their grandchildren.[1]

Phase 1: Accumulation

Jeff and Kim

Phase 2: Distribution



Daniel

Matt

Kate

Phase 3: Post-death planning

Sophie

Jason

Abby

Jeff and Kim's estate

At the death of first spouse (Jeff)

B TRUST FUNDED

- Also called a credit shelter trust or bypass trust
- Created to preserve the decedent's estate tax exclusion (The 2024 exclusion amount is $13.61M–Single, $27.22M–Married Filing Jointly)[2]
- Allows assets to grow outside of the decedent's estate and will pass estate-tax-free to the beneficiaries
- Trust planning can also help in states that collect their own separate estate tax

These examples presented may not be appropriate for all investors.

[1] The Bensons are hypothetical examples for illustrative purposes only. They are provided for informational purposes and are not intended as investment advice or a recommendation. Your individual circumstances may vary. You should consider your individual situation, including your time horizon, risk tolerance, investment objectives, and the need for an annuity before investing. Assumes no distributions are taken in phases one or two. Calculations performed by Jackson.

[2] IRS, Rev. Proc. 2023-34, 2023.

Leveraging the trust-owned annuity

After Jeff's death, as the income beneficiary, Kim is discussing investment options with her financial professional and is evaluating the benefits and disadvantages of placing trust assets in taxable and tax-advantaged accounts. When a trust is initially funded, the asset allocation is typically based on the terms of the trust, the objectives of the trust, and the current economic environment.

OPTION 1: MAINTAIN TRUST ASSETS IN INCOME-GENERATING INVESTMENTS

If the trust retains income, as we see below, earnings are subject to more compressed tax brackets than those of individuals.

2024 Married filing jointly tax rates	
$0 – $23,200	10%
$23,201 – $94,300	12%
$94,301 – $201,050	22%
$201,051 – $383,900	24%
$383,901 – $487,450	32%
$487,451 – $731,200	35%
$731,201+	37%

2024 Trust tax rates	
$0 – $3,100	10%
$3,101 – $11,150	24%
$11,151 – $15,200	35%
$15,201+	37%

Source: IRS, Rev. Proc. 2023-34, 2023.

DID YOU KNOW? A $1 million trust would only need to generate approximately 1.52% ($15,201) in retained earnings to be subject to the top trust tax rate of 37%—then add another 3.8%, (Medicare tax) for a total trust tax rate of 40.8% + potential state taxes.[3]

OPTION 2: REALLOCATE A PORTION OF TRUST ASSETS INTO A TAX-DEFERRED* ANNUITY

Why use annuities in trusts? Many trusts are eligible for tax deferral under IRC Section 72(u), and during the accumulation phase, annuities can offer three key benefits.[4]

Grow assets with tax deferral

The threshold to eclipse the top trust tax rate of 40.8% (37% + 3.8% additional Medicare tax) is only $15,201. While trust income can be distributed to income beneficiaries to lessen the trust tax effect, keep in mind, those distributions can also reduce the size of the trust and can impose an added—and perhaps unwanted—tax burden on the income beneficiary. For irrevocable trusts, passing income to the income beneficiary also moves funds that are outside of an estate, and free from estate tax, back into a potentially taxable estate.

Control to turn income on and off

An annuity can also provide the trustee with control over the recognition of income.[5] With a tax-deferred annuity, a trustee can request a distribution when income is needed, but otherwise, avoid recognizing income from the annuity if it is not needed.[*,6]

Simplify management and reporting

The allocation of the trust assets may need to be modified. By using an annuity as part of the trust investment strategy, the trustee can adjust the asset allocation within the annuity without triggering additional transaction costs or capital gains.[7]

TO DEFER OR NOT TO DEFER

See how the $1 million fares in the trust-owned annuity vs. a taxable account.

Year 1

Jeff passes away. The trustee splits **$1,000,000** of the B trust assets to fund three equal nonqualified annuities, one for each remainder beneficiary.

Year 5

The combined account balance grows to **$1,338,226.** A taxable account would have only grown to **$1,214,431**

Data above assumes an average growth rate of 8% with a 2% fee. No distributions are taken from either account over the 10-year period.

Investing in taxable or tax-deferred vehicles involves risk, and you may incur a profit or loss in either type of account. Changes in tax rates and tax treatment of investment earnings may also impact comparative results. Investors should consider their personal investment horizon and income tax bracket, both current and anticipated, when making an investment decision, as these may further impact the comparison.

The IRS issued a private letter ruling ("PLR") holding that a non-grantor trust cannot use the IRC 72(q) exceptions for (1) reaching age 59½, (2) disability, or (3) SEPP payments. The ruling recognized a non-grantor trust may use the IRC 72(q) exception for death. (See PLR 202031008).

* Tax deferral offers no additional value if an IRA or a qualified plan, such as a 401(k), is used to fund an annuity. It also may not be available if the annuity is owned by a legal entity such as a corporation or certain types of trusts.

[3] IRS, "Topic No. 559 Net Investment Income Tax," April 6, 2023.

[4] Trusts that do not meet the requirements of 72(u) will not receive the benefit of deferral under a deferred annuity and will be taxed currently on the gains in the contract.

[5] Distributable Net Income (DNI) is the taxable income of the trust computed with certain modifications, Cornell, Legal Information Institute, IRC Section 643(a).

[6] Tax-deferred annuity growth does not contribute to Distributable Net Income.

[7] 25 free transfers per year; $25 per trade thereafter.

ACCUMULATING THE LEGACY

Kim chooses option 2, repositioning assets into a tax-deferred annuity.

After Jeff has passed away and the trust is funded, Kim has rights to income from the irrevocable B trust throughout her lifetime. Kim's financial professional is aware of Jeff and Kim's goal to create a strong financial legacy for their heirs and tells her to consider placing a portion of the trust's $13.61 million[8] inside an annuity to take advantage of the accumulation benefits of tax deferral, income control, and simplified management.

Let's take a look at what could happen if Kim chooses to purchase an annuity in the amount of $1 million within the newly created B trust—and what could happen if she chooses to put that money into a taxable account.

Assumptions*

- Starting Investment = $1 million
- Average growth rate = 8% less a 2% fee
- Kim elects not to take any income from the taxable account or the annuity that equals a growth rate of $60,000+ per year

More to the story

If the trust retains the $60,000+ in income it earns each year in the taxable account, it will be exposed to the top trust tax rate of 40.8% (37% + 3.8% additional Medicare tax). Remember, even though she didn't do it in this example, Kim can still trigger a distribution from the annuity(ies) at any time by simply requesting a withdrawal.

Options for where Kim places the money		
	Taxable account	Nonqualified tax-deferred annuity
Year 1 (Jeff's Death)	$1,000,000	$1,000,000
Year 5	$1,214,432	$1,338,226
Year 10	$1,472,575	$1,790,848

The tax-deferred annuities generate a combined additional $318,272.

Year 10

The combined account balance grows to **$1,790,848.** By contrast, the taxable account would have only grown to **$1,472,575.**

Withdrawals of tax-deferred accumulations are subject to ordinary income taxes. If withdrawn prior to age 59½, there may be an additional 10% federal tax penalty imposed. Lower maximum tax rates on capital gains and dividends could make the investment return for the taxable investment more favorable, thereby reducing the difference in performance between the hypothetical investments shown.

* Values calculated assume ordinary income tax rates for an irrevocable trust.

[8] IRS, Rev. Proc. 2023-34, 2023.

Passing down the benefits

As a reminder, many trusts are set up to benefit two types of individuals: those who receive income from the trust (income beneficiary, Kim) and those who receive assets when the trust dissolves (remainder beneficiaries, Jeff and Kim's children). In addition to the accumulation benefits just discussed, annuities also provide two key wealth-transfer options. In phase one, the trustee has two titling options for the annuities.[9]

OPTION 1: STANDARD TITLING IS OPTIMAL FOR PROVIDING LIQUIDITY

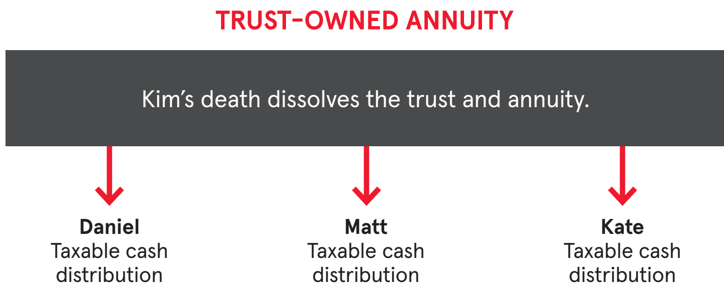
Owner: Irrevocable trust

Annuitant: Surviving spouse (Income beneficiary)

Beneficiary: Irrevocable trust

In this scenario, the children need liquidity at their mother's death and choose to use the cash for reducing debt, home renovations, and vacations.

At Kim's death, the annuity death benefit is triggered and the trust dispenses the death benefit (cash) according to the trust terms. This will be a taxable event to the beneficiaries (or the trust, if retained) in the amount of their proportionate share of the gain.



OPTION 2: "PASS-IN-KIND" TITLING IS OPTIMAL FOR EXTENDING TAX-DEFERRAL BENEFIT

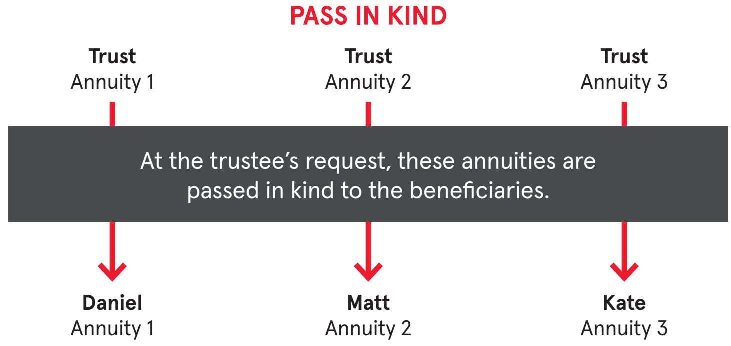
Owner: Irrevocable trust

Annuitant: Child (Remainder beneficiary)

Beneficiary: Irrevocable trust

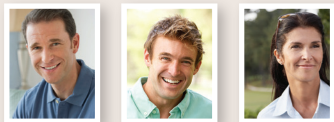
With titling option 2, the goal is to maximize the period of tax deferral. In this example, Kim's death triggers the distribution of trust assets. When the remainder beneficiary(ies) are entitled to their share of the trust, the annuity can be retitled from the trust as owner, to the annuitant (child) as owner, and this does not trigger a taxable event.[10]

Note: If the goal is to pass annuity assets in kind to trust beneficiaries, a separate policy should be opened for each trust beneficiary, naming them individually as annuitant on each policy.



TURNING MUCH INTO MUCH MORE—THROUGH PASS IN KIND.

See how the children grow their inheritance through the benefits of tax deferral.



Year 10

The combined account balance is **$1,790,848** when Kim dies, triggering distribution of trust assets.

The trustee then passes the annuity contracts in kind to Daniel, Matt, and Kate.

Year 15

Daniel, Matt, and Kate's annuity accounts continue to grow tax deferred, and are each worth **$798,853**, or **$2,396,558** across all three contracts.

Data above assumes an average growth rate of 8% with a 2% fee. No distributions are taken from either account for the first ten years.

[9] For a person to be listed as the annuitant, the individual must qualify as a beneficial owner (i.e., income or remainder beneficiary readily identifiable from the trust document).

[10] IRS Private Letter Ruling (PLR) #199905015, says (1) an annuity owned by the credit shelter trust ("B trust") is deemed to be owned by a natural person for purposes of Section 72(u) and, (2) upon dissolution of the trust, the retitling of the annuity contract from the trust as owner to the annuitant as owner does not trigger a taxable event.

CREATING A LEGACY

Kim instructs the trustee to choose option 2, the pass-in-kind option.

- Kim dies ten years after Jeff, triggering dissolution of the trust that ends phase one and begins phase two: distribution.
- When Kim passes away, the 10-year-old annuity contracts have grown to $1,790,848.
- To effectuate the pass-in-kind option, each remainder beneficiary must be the annuitant on their own contract, requiring three separate trust-owned contracts with each child listed as annuitant on their own contract. Daniel, Matt, and Kate each receive a pass-in-kind distribution of the annuity at Kim's death.
- The retitling of the annuity contract from the trust as owner to the three annuitants as owner continues the benefit of tax deferral and does not trigger a taxable event.
- Each child owns their own annuity, valued at $596,949.
- They can take income if they wish; however, there may be several tax implications for doing so (see inset to the right).

More to the story

Let's focus now on Daniel, age 55, Jeff and Kim's oldest child. At the time of his mother's death, Daniel's annuity was passed in kind to him, valued at $596,949, and is titled as follows:

Owner: Daniel

Annuitant: Daniel

Beneficiary: Sophie

He is now the outright owner and may take distributions if he wishes. If he does take a distribution, he will be taxed on that distribution at his ordinary income tax rate. Note too, if he takes the distribution before age 59½, he may be subject to a 10% additional tax unless an exception to the tax is met.[11]

The combined total of all three children's annuities is now $3,207,135.

Year 20

Daniel, Matt, and Kate's annuity accounts grow, each worth **$1,069,045.** Daniel passes away.

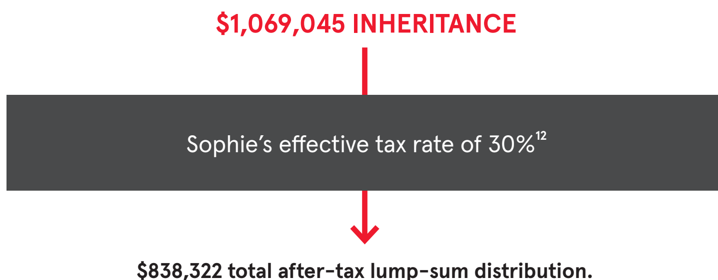
[11] IRS Publication 575, "Pension and Annuity Income" April 12, 2023.

Stretching the legacy

Ten years after assuming ownership of the annuity, Daniel dies at the age of 65, triggering phase three of our story. At the time of his death, the annuity has grown to $1,069,045. Sophie, Daniel's only child, is 35 when her father passes away. As Daniel's listed beneficiary, Sophie is evaluating whether to receive the annuity death benefit as a lump sum, over five years, or through a series of systematic withdrawals.

OPTION 1: TAKING THE ANNUITY'S DEATH BENEFIT AS A LUMP-SUM OR OUT IN FIVE ARE THE LEAST TAX-EFFICIENT OPTIONS.

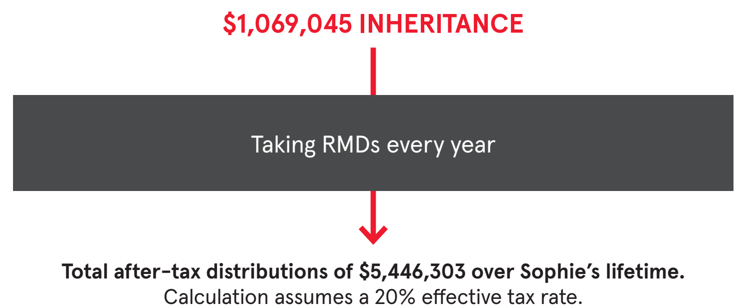
Sophie would receive a lump-sum distribution from the annuity. This could trigger a significant taxable event, eliminating a substantial amount of her inheritance. Sophie could also choose an out-in-five option, which would require the annuity to be completely liquidated by the end of the fifth year after she inherits it.



$838,322 total after-tax lump-sum distribution.

OPTION 2: TAKING THE ANNUITY'S DEATH BENEFIT AS A NONQUALIFIED STRETCH EXTENDS THE TAX-DEFERRAL BENEFIT

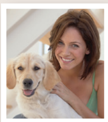
Sophie would need to take a Required Minimum Distribution (RMD) each year based on her life expectancy.[13] This allows the remaining amount to continue to grow on a tax-deferred basis.



Total after-tax distributions of $5,446,303 over Sophie's lifetime.
Calculation assumes a 20% effective tax rate.

THE GRANDPARENT'S WISH FULFILLED

See how Sophie can stretch the inherited amount based on her life expectancy.



Year 21

Sophie, age 35, takes her first RMD of **$22,439** from the annuity, while the account balance grows to **$1,110,749.**

Year 30

Sophie takes an RMD of **$37,911** while the account balance grows to **$1,535,389.**

Year 40

Sophie takes an RMD of **$67,893** while the account balance grows to **$2,070,722.**

Data above assumes an average growth rate of 8% with a 2% fee and 20% effective tax rate. No distributions are taken from either account over the 10-year period.

[12] IRS, Rev. Proc. 2023-34, 2023.

[13] RMD=12/31 Account Balance/Factor. Based on IRS, Department of the Treasury, IRS, Department of the Treasury, Publication 590-B, April 4, 2023. All values calculated assume a 2% fee on the stretch account.

THE BENEFITS OF THOUGHTFUL PLANNING

Sophie chooses option 2, the nonqualified stretch option.

- The additional 10% federal tax for withdrawals before age 59½ doesn't apply to Sophie because she is receiving an annuity death claim.
- Funds will continue to grow on a tax-deferred basis until distributed.
- While Sophie has to take an RMD every year, she also has the flexibility to take a greater withdrawal, if needed.
- As distributions are taken, gains will be withdrawn first and taxed at her individual ordinary income rate, while basis is withdrawn last and is tax-free.

More to the story

If Sophie were to die before the funds are exhausted, then Sam, Sophie's son and beneficiary, would have the option of continuing the nonqualified stretch based on Sophie's life expectancy, adding another generation that benefits from the inheritance.

Thanks to the foresight of her grandparents and father, Sophie's inheritance provided a lifetime of income.

Year 50

Sophie takes an RMD of **$121,585** while the account continues to grow to **$2,492,496.**

Year 60

Sophie takes an RMD of **$217,741** while the account balance grows to **$2,286,276.**

Year 68

Sophie, now age 82, takes her final RMD of **$347,045** and the account balance now equals **$867,613.**

A legacy fulfilled

Kim's initial decision to place $1 million of trust assets into tax-deferred annuities grew to **$1,790,848** over 10 years.

Due to the pass-in-kind titling, the children, Daniel, Matt, and Kate, each inherit an annuity worth one-third of this amount, or **$596,949,** when Kim passes away. In Daniel's case, the annuity continues to grow tax-deferred to **$1,069,045** over 10 years because he does not take any distributions.

The grandchild, Sophie, chooses the nonqualified stretch method to receive her death benefit, and the pre-tax RMDs last 51 years and total **$6,721,621** before taxes, and **$5,446,303** after taxes.

If the same assumptions and outcomes were applied to the other children, grandchildren, and their beneficiaries, the entire pre-tax value of that original $1 million trust-owned annuity would be **$20,164,864.**

- **Beneficial owner** – Person who enjoys the benefits of ownership even though title may be held in a different name.
- **B Trust** – Also called a Credit Shelter or Bypass trust. This trust is formed when a will is written bequeathing an amount to the trust. Once money is placed in an irrevocable B trust, the assets pass estate-tax free to the beneficiaries.
- **Grantor** – A person who creates a trust; also called settlor, creator, or trustor.
- **Income beneficiary** – One who receives income from a trust.
- **Irrevocable trust** – If the grantor gives up the right to revoke the trust after it becomes effective, including the right to change any of the terms or provisions of the trust, then the trust is said to be an "irrevocable" trust. Appreciated assets in the trust are not subject to estate taxes.
    - **Common types include:** SLATs, QTIP trusts, Credit Shelter trusts (also called a Bypass trust or B trust), Special Needs trusts, Generation Skipping trusts, and Irrevocable Family trusts.
- **Nonqualified stretch** – Series of systematic withdrawals based on beneficiary's life expectancy according to IRS Table I from Publication 590-B.
- **Remainder beneficiary** – Person who receives the principal of a trust when it dissolves.
- **Trustee** – The holder of legal title to property for the use or benefit of another and maintains a fiduciary duty to trust beneficiaries.

Ready to put an annuity to work for your trust-owned accounts?

You've seen how using annuities in the accumulation, distribution, and post-death planning phases of trust ownership can be a strategic opportunity that offers the potential for three to four generations of tax deferral.

So, what's the best way to get started?

- To identify opportunities, look for trust accounts registered with a taxpayer identification number (TIN), and schedule a review to see if the trust could benefit from a Jackson® annuity.
- For new business, complete the application, indemnification agreement, and trustee certification of investment powers, and submit along with a copy of the trust.

The professionals from Jackson's Advanced Strategies are only a phone call away and can provide you with more information.

Call 800/866-4510, ext. 57149 for help with your trust-planning questions and cases.

Before investing, investors should carefully consider the investment objectives, risks, charges, and expenses of the variable annuity and its underlying investment options. The current contract prospectus and underlying fund prospectuses provide this and other important information. Please contact your financial professional or the Company to obtain the prospectuses. Please read the prospectuses carefully before investing or sending money.

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Tax deferral offers no additional value if an IRA or a qualified plan, such as a 401(k), is used to fund an annuity. It also may not be available if the annuity is owned by a legal entity such as a corporation or certain types of trusts.

Diversification does not assure a profit or protect against loss in a declining market. Portfolios that have a greater percentage of alternatives may have greater risks, especially those including arbitrage, currency, leveraging, and commodities. This additional risk can offset the benefit of diversification.

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