

# Understanding trust-held nonqualified annuities

Allianz Life Insurance Company of North America  
Allianz Life Insurance Company of New York

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For all that's ahead.\*

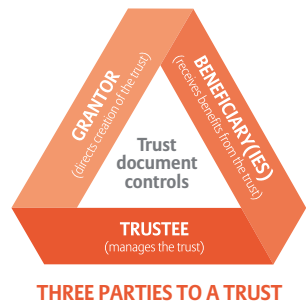
**Allianz** 

# About trust-held nonqualified annuities

There are times when you may want to consider having a nonqualified annuity owned by a trust. Whether or not you should name a trust as the owner (or beneficiary) of your nonqualified annuity contract may depend on several factors, which you should discuss with your estate-planning attorney. But first it's important to understand what a trust is and how it works. We'll explain some of the basics in this publication.

## What is a trust?

A trust is a legal document designed to meet the goals and objectives you have for the management and control of certain property you place under the trust's control. The trust document specifies how the property should be managed and distributed, and is subject to state law. Keep in mind that an attorney must draft your trust document.



### Most trusts involve three parties:

- The grantor (or settlor) is the individual who directs the creation of the trust.
- The trustee will manage the trust and the assets in it, as indicated by the document.
- The beneficiaries of the trust are those individuals or entities who will receive benefits from the trust. There are generally two types of beneficiaries – income beneficiaries and remainder beneficiaries. Income beneficiaries receive income from the trust and remainder beneficiaries receive the principal when the income interest ends, often due to a death.

There are certain trusts that do not have a grantor and are set up by operation of law, but we won't cover those here. See your local attorney for more information about those types of trusts.

## Trusts can be established for many reasons:

- To manage and control assets for family members.
- To stipulate how beneficiaries receive income. A trust can stipulate when trust beneficiaries are to receive income from the trust (such as at certain ages or as needs arise).
- To avoid probate. A trust is a private arrangement and is not part of public records when probate is involved. Trusts may be established and funded with assets to avoid the probate process at death.
- To reduce estate taxes.

## Should I place my nonqualified annuity in a trust?

When deciding whether to name a trust as the owner of a nonqualified annuity contract, it's important to consider both the trust's goals and the annuity's benefits. This is because a nonqualified annuity contract owned by a trust may or may not meet the goals of the trust.

For example, if you're establishing a trust primarily to avoid probate, placing a nonqualified annuity in this trust would not yield additional advantages because annuity contracts already have named beneficiaries that allow death benefits to be passed to beneficiaries, thus avoiding probate. In this case, it may be possible for you to achieve additional goals while still avoiding probate by owning an annuity individually or jointly with your spouse.

It's also important to consider the tax implications, because some trusts have high income tax rates. If an irrevocable trust holds income without distributing it to the trust beneficiaries, for example – and if the trust is the type that pays income taxes – the trust can be taxed at the 37% rate with just \$12,500 or more of taxable income (for 2018). In addition, at that level of taxable income for certain trusts, there is an additional 3.8% Medicare surtax on net investment income. If a trust is holding income for any length of time and pays income taxes, it may be advantageous to have the tax-deferred growth a nonqualified annuity provides.

### 2018 TAX RATES FOR ESTATES AND TRUSTS

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\$0-\$2,550 .....	10%	\$9,150-\$12,500 .....	35%
\$2,550-\$9,150 .....	24%	over \$12,500 .....	37%

Typically, nonqualified annuities owned by revocable (“living”) trusts and irrevocable trusts can qualify for tax-deferred growth as long as all trust beneficiaries are natural persons. For example, if your irrevocable trust names your favorite charity or your local church as one of its beneficiaries, it would not qualify for tax-deferred growth. The attorney who drafted the trust should be able to determine if the trust is acting as an agent for a natural person (Internal Revenue Code (IRC) Section 72(u)) and qualifies for income tax deferral. For an irrevocable trust, Allianz Life Insurance Company of North America (Allianz) or Allianz Life Insurance Company of New York (Allianz Life® of NY) require the legal, tax advisor, or professional trustee for the trust to certify that the trust is acting as an agent for a natural person under IRC Section 72(u).

## Other questions to consider

### **When does the death benefit get paid out on a trust-owned annuity?**

With a trust-owned annuity, most nonqualified annuity contracts pay a death benefit at the death of the named annuitant, NOT at the death of the grantor of the trust or death of the trustee. Therefore, you should take care in naming the annuitant and make sure that the named annuitant aligns with the terms of the trust, as well as the trust’s goals. For example, if a trust says to make payments to a child when they attain age 60, the child may be a better fit as the annuitant than the parent, as the contract with the child named as annuitant would continue past the parent’s death.

### **Who receives the death benefit after the annuitant dies?**

When a trust is the owner of the nonqualified annuity, the trust is generally the beneficiary of the annuity. After the annuitant dies the death benefit from the annuity, if any, is then paid to the trust and the terms of the trust document control how the death benefit is managed and distributed. Naming any beneficiary other than the trust creates the risk that the trust will not be funded upon the annuitant’s death.

### **When a distribution is taken from a trust-owned nonqualified annuity, how is it taxed?**

The insurance company that issues the annuity may look to the age of the annuitant when reporting whether or not a distribution is subject to the 10% federal additional tax for distributions under 59½ years of age. If a trust requires distributions before the annuitant reaches 59½ years of age, the 10% federal additional tax for early distributions may apply.

### **When a trust owns the contract, can the annuitant's spouse continue the trust-owned contract or continue joint income?**

No. The Internal Revenue Code (IRC) allows a surviving spouse beneficiary to continue the contract only if the deceased spouse was the owner or joint owner of the nonqualified annuity. As you can only be married to an individual, a trust-owned contract cannot be continued at the death of an annuitant.


### **Does having the trust as owner or beneficiary have any effect on what happens to the death benefit options?**

Yes. The IRC requires that all death benefit payouts with a trust beneficiary of a nonqualified contract be paid out within five years of the date of death. If a trust-owned contract contains a large amount of earnings, all amounts in the annuity – including any earnings – will have to be paid out to the trust beneficiary within five years. The earnings would be subject to ordinary income tax. Alternatively, if a contract is owned individually and left to a designated beneficiary, the beneficiary may have the option to take distributions over their life expectancy and spread out those taxable earnings over a longer time frame.

Allianz Life Insurance Company of North America and Allianz Life Insurance Company of New York permit most types of trust ownership with their nonqualified annuities.

Whether a trust should own your nonqualified annuity is not a simple question. See your estate-planning attorney for further information on trusts, and talk to your financial professional about nonqualified annuity products that may be appropriate for you.

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