Protective

CHARITABLE GIVING CONCEPTS

Wealth Replacement Technique

The Concept...

- Donors may hesitate to make substantial gifts to charity out of a legitimate concern that they'll give away assets that family members may eventually need.
- For these donors, "wealth replacement" (also known as a capital replacement) may be the answer.
- The wealth replacement technique combines three tools—a charitable remainder trust, a life insurance policy and an irrevocable life insurance trust—in a strategy that uses life insurance to replace estate assets donated to charity.

The Process...

- The donor irrevocably transfers property to a charitable remainder trust (CRT).
- The CRT uses income from the transferred property to pay the donor an annual income (based on a percentage of the trust assets) for life or for a term of up to 20 years.
- The donor also establishes an irrevocable life insurance trust (ILIT) in which the donor has no interest or incidents of ownership.
- The ILIT trustee buys a life insurance policy on the donor's life (or a second-to-die policy insuring both the donor and spouse) with death benefits equaling or exceeding the value of the property transferred to the CRT.
- The donor uses the income received from the CRT each year to make gifts to the ILIT. The trustee uses these gifts to pay the insurance premiums.

For the Charity...

- At the end of the trust term, the assets remaining in the CRT are distributed to the designated charity, fulfilling the donor's philanthropic goal.

For the Family...

- The irrevocable life insurance trust owns a life insurance policy on the donor's life. The donor retains no rights to revoke, terminate or modify the ILIT.

- The trustee pays the insurance premiums from the donor's annual gifts to the trust.
- At the donor's death, the life insurance proceeds are paid to the ILIT, where the trustee manages the proceeds and makes distributions to the ILIT beneficiaries in accordance with the terms of the trust.

For the Donor...

- The strategy fulfills the donor's goal of making a substantial charitable gift.
- The year the gift is made, the donor qualifies for an income tax charitable deduction for the present value of the charity's remainder interest in the CRT.
- The strategy allows the donor to avoid a capital gains tax on the appreciated property at the time the property is transferred to the CRT.
- An ordering sequence determines the tax character of distributions to trust beneficiaries: first ordinary income, then capital gains, then any other income and finally principal.
- The donor replaces all or a portion of the assets donated to the CRT with life insurance to benefit the heirs.
- When properly arranged, a wealth replacement strategy removes both the donated property and the life insurance from the donor's gross estate for federal estate tax purposes.

The Bottom Line...

With proper planning and the right tools, a donor doesn't have to abandon a desire to leave a substantial gift to charity out of a concern that family members will be adversely affected.

SUMMARY

Why Wealth Replacement?

Sometimes, philanthropically minded donors hesitate to make substantial charitable gifts out of a concern that gifts could compromise the financial security of their families.

In cases like this, "wealth replacement" (also called capital replacement) creates an opportunity to satisfy the dual goals of providing for beneficiaries and supporting a favored charity.

How Does the Arrangement Work?

The wealth replacement technique uses a charitable remainder trust, an irrevocable life insurance trust and a life insurance policy. The donor first sets up and transfers cash or property to a charitable remainder trust (CRT), which will pay the donor an income for life or for a term of up to 20 years.

The donor then sets up an irrevocable life insurance trust (ILIT) in which the donor has no interest or incidents of ownership.

The donor uses each year's income payments from the CRT to make annual gifts to the irrevocable life insurance trust. The ILIT then uses those funds to pay the annual premiums on the life insurance policy.

When structured correctly, at the donor's death, the charity receives a substantial gift of the remaining CRT assets, and the ILIT receives the life insurance proceeds and uses them as directed to benefit the donor's heirs.

What Are the Benefits?

From a tax standpoint, the donor qualifies for a federal income tax deduction for the present value of the charity's remainder interest in the CRT. Additionally, the donor pays no capital gains tax upon the transfer of appreciated property to the CRT. Finally, if ownership is structured properly, the strategy removes both the donated property and the life insurance from the donor's gross estate for federal estate tax purposes.

Donors using the wealth replacement technique typically find that the greatest benefit is the opportunity to make a substantial gift to a favorite charity without compromising a family's financial security. The answer lies in using trusts and life insurance to replace assets donated to charity.

1

A donor who wishes to make a substantial gift without compromising family inheritances creates a charitable remainder trust (CRT) and funds it with long-term appreciated property. The donor qualifies for a federal income tax deduction for the present value of the charity's remainder interest, subject to limitations.

DONOR

2

The donor also creates an irrevocable life insurance trust (ILIT) and funds it with a life insurance policy. The face amount equals or exceeds the value of the property transferred to the CRT.

CRT

DEED

Corporation

CERTIFICATE OF STOCK

3

The CRT pays the donor an income for life, or for a term of up to 20 years. To make these payments, the trustee sells the appreciated property without paying capital gains tax and buys income-producing assets.

ILIT

INSURANCE POLICY ON DONOR'S LIFE

4

The donor uses the CRT income to make gifts to the ILIT to cover the insurance premiums. These gifts are only sheltered by the gift tax exclusion if the trust beneficiaries have Crummey powers—the power to withdraw the annual gift within a specified window of time.

CHARITY

5

At the donor's death, the ILIT receives the insurance proceeds, which are paid to the donor's heirs to "replace" the donated property. The remainder in the CRT goes to the charity.

DONOR'S HEIRS

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