Leaving a Legacy

For millions of Americans, "charity begins at home." Many have decided to make a difference by donating money to local religious, educational, social, or cultural organizations. In addition to the immense satisfaction that comes from giving to others, charitable giving can provide tax benefits for the donor and his or her heirs when done as part of an overall estate plan.

Charitable Gifts of Life Insurance

Gifts of **life insurance** have unique advantages, including the following:

- The proceeds are generally received income- and estate-tax free by the charity.
- Under certain circumstances, the proceeds may pass to the charity outside the will, avoiding **probate** proceedings.
- In combination with a wealth replacement trust, assets may be kept intact for the donor's family, as described below.

Gifts of life insurance can be made in one of two ways:

- The ***insured*** is the owner of the policy, and the charity is the beneficiary. This arrangement is used when an insured/donor wishes to retain control over the insurance policy. Because the insured owns the policy at death, the death benefit will be included in his or her estate for tax purposes, but it will be 100% deductible, since it is payable to a charity. However, premiums are *not income tax deductible*.

- The ***charity*** is owner *and* beneficiary. Unlike the situation in which the insured retains ownership, the premiums are considered a charitable gift and may be income tax deductible to the donor according to Internal Revenue Service (IRS) guidelines.

If the donor gives an *existing* policy to a charity, the fair market value of the policy (generally, its full cash value) is allowable as an income tax deduction. The tax consequences of future premium payments for the gifted policy would be the same as the situation described above, in which the charity is both owner and beneficiary.

Charitable Remainder Trusts

If the prospective charitable donor is seeking a way to increase income, reduce estate and income taxes, avoid taxes on gains, and make a significant charitable contribution without reducing his or her family's inheritance, a charitable remainder trust (CRT) or a wealth replacement trust may be appropriate. A CRT can allow an individual to make a gift to a charity while retaining a current income interest in the gifted asset during his or her lifetime.

In general, it may be best to fund a CRT with an asset that, if sold outside the trust, would produce substantial long-term capital gains tax. After the trust is executed, the donor may transfer this appreciated, low- or non-income-producing asset to the CRT. The CRT can then sell the asset and provide the donor an income for life, for a term of years, or for joint lives. Upon the death of the donor or the donor's named non-charitable-income beneficiary, the remaining trust assets will pass to the charity. Here are some of the benefits of this strategy:

- When the trust is created, the donor may get a current income tax deduction based on the present value of the future amount passing to the charity.
- No tax on the gain is paid by the trust when it sells the asset, since the trust is exempt from such tax.
- The donor may get increased income, since the trust may invest in assets paying a higher rate of return than the contributed asset was producing, and the trust may have more to invest, since it doesn't pay tax on the gain.
- Estate taxes are reduced, since the asset placed in the trust has been removed from the estate.

After the donor's death, the remaining assets in the trust pass to the charity, not to the donor's heirs. However, the tax savings produced by the charitable donation and the income generated by the trust can be used to pay premiums on a life insurance policy owned by an **irrevocable life insurance trust (ILIT)—**sometimes known as a "wealth replacement" trust. The life insurance policy in this trust replaces the value of the assets that pass to the charity in the CRT. Since the life insurance is purchased and owned by the irrevocable trust, the proceeds are free of income tax, as well as estate tax.

There are a variety of charitable giving tools and techniques that can provide generous donors with certain tax benefits. For specific guidance, consult your qualified tax and legal professionals.

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