Leave a Legacy

For millions of Americans, “charity begins at home.” That’s where they’ve 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, when done as part of an overall estate plan, charitable giving can provide tax benefits for the donor and his or her heirs (IRC Section 170(a) through (c)).

Charitable Gifts of Life Insurance

- Gifts of life insurance have some unique advantages:
- Life insurance is a contract and passes outside the will, so it generally cannot be contested in probate proceedings.
- Since the payment of a life insurance policy death benefit to a named beneficiary is not part of the probate process, it is private—not a matter of public record like assets passing by will.
- Although payment of the life insurance death benefit is deferred, there may be some present benefits to the charity, since generally the cash values are available currently.
- The proceeds are generally received income and estate tax free by the charity.
- There are no probate delays.
- Assets are kept intact for the donor’s family.

Gifts of life insurance can be made in essentially two ways. Under the first, the *insured* is the owner of the policy and the charity is the **beneficiary**. This arrangement is used when an insured/donor desires to retain control over the insurance policy. Under this arrangement, the premiums are not *income tax deductible*. Additionally, since the insured owns the policy at death, the death benefit will be included in his or her estate under IRC Section 2042, but it will be 100% deductible from the estate, since it is payable to a charity (IRC Section 2055).

Under the second, the **charity** is *owner* and beneficiary. Unlike the situation where the insured retains ownership, the premiums may be income tax deductible within IRS guidelines.

If the donor gives an existing policy to charity, the value of the policy (generally, its **cash surrender value** plus any unearned premiums) or the policyholder’s basis (normally the premiums paid), whichever is less, is allowable as an itemized income tax deduction. (See IRC Section 170(e)(1)(A), and Tuttle v. U.S., 436 F.2d 69 (2d Cir. 1970).) The tax consequences of future premium payments for the gifted policy would work as described above where the charity is both owner and beneficiary.

Charitable Remainder Trusts (CRTs)

If the prospective charitable donor is looking for 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 and a **wealth replacement trust** may be the right tools. A CRT can allow an individual to make a gift to a charity while retaining an interest in the gifted asset during his or her lifetime.

CRT Mechanics and Tax Aspects

As a general rule, 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 transfers this appreciated, low or non-income producing asset to the CRT. The CRT sells the asset and gives the donor an income for life, for a term of years, or for joint lives. At the death of the donor or the donor’s named non-charitable income beneficiary, the remaining trust assets pass to the charity. Here are some of the benefits of using this strategy:

- Upon creation of the trust, the donor gets a current income tax deduction based on the future amount passing to the charity (IRC Sections 170(f)(2)(A) and 664(e)).
- No tax on the gain is paid by the trust, since the trust is exempt from such tax when it sells the asset.
- The donor gets increased income, since the trust may invest in assets paying a higher rate of return than the asset contributed was producing, and the trust has 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.
- The Irrevocable Life Insurance Trust

After the donor’s death, the remaining assets in the trust pass to the charity. The assets do not pass to the donor’s heirs. 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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