Inside COLUMBUS LIFE

Charitable Giving and Life Insurance

Can Two Strategies Be Better Than One?

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Charitable planning involving charitable remainder trusts and life insurance has been around a long time. Let's look closer at two strategies.

One traditional strategy begins with clients donating a highly appreciated asset to a **charitable remainder trust (CRT)** generally during their lifetime and then establishing a **wealth replacement trust (WRT)** funded with life insurance. Thanks to the SECURE Act, a second strategy—leaving a CRT as the beneficiary of a qualified plan or IRA—is attracting new interest. And this second strategy has a life insurance angle as well.

Traditional CRT and Life Insurance Strategy

If a donor simply sells a highly appreciated asset, the donor will be taxed on the capital gain in the year of the sale. If instead, the donor gives the highly appreciated asset to a CRT, the CRT can sell the asset and invest the proceeds without paying any income tax. In return, the donor receives a stream of income payments from the trust for a period not to exceed 20 years or for lifetime (or a joint lifetime).

The payments will be a fixed amount under a **charitable remainder annuity trust (CRAT),** or a fixed percentage under a **charitable remainder unitrust (CRUT).**

The payments will be taxable to the donor under a tiered approach (ordinary income, capital gains, tax-exempt income, and return of basis). At the end of the period, the charity (the remainder beneficiary) receives the assets remaining in the trust. Not only does the donor not have to include all the capital gain in income in that first year, the donor can receive an income tax deduction in that year for the projected remainder interest passing to the charity (assuming all requirements are met).

Where does life insurance fit into this strategy?
A WRT is established to help replace the value of the assets donated to charity. Some of the income and tax savings generated by the gift to the CRT are used to purchase a life insurance policy on the life of the donor. The WRT is generally an irrevocable life insurance trust (ILIT) and is the owner and beneficiary of the life insurance policy. The donor's natural heirs are the beneficiaries of the WRT. The beneficiaries generally receive the death proceeds income-tax free and estate-tax free. (CRAT example below)

Charitable Remainder Annuity Trust (CRAT) — Example

› 20 Year Term › Annual Payout › Sec. 7520 Rate: 3.00% › Fair Market Value of Trust: $1,000,000	Amount of Annuity:	$50,000
	Present Value of Annuity:	$802,010
	Charitable Remainder:	$197,990
	Charitable Deduction for Remainder Interest:	$197,990

Naming a CRT as Beneficiary of Qualified Plan or IRA Assets

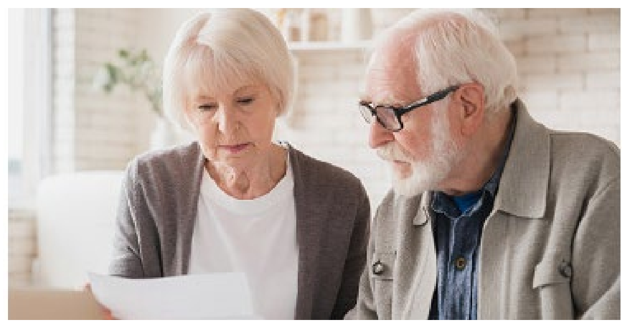
The SECURE Act eliminated the right of clients' healthy adult children to stretch inherited qualified plan and IRA assets over their lifetime. The ability to stretch the taxation of those pre-tax funds over the sometimes long life expectancy of the clients' adult children was a passable legacy strategy. Having to pay those amounts out over a 10-year period is not a good legacy strategy. Some clients may be willing to spend some of those assets now (and incur current taxation) to fund tax-free legacy options, such as life insurance or Roth conversions. But some may be looking for a third option—a way to duplicate the stretch option that was lost.

Leaving their qualified plan and IRA assets to a CRT might be a viable strategy. Let's look at how the CRT would work as a substitute stretch. Most likely, the beneficiary CRT would be a CRUT.

Using a CRUT as a Substitute Stretch

Payments from a CRUT are adjusted annually based on the current value of the trust assets, providing for inflation protection and ensuring that the trust assets are never exhausted. Using the minimum 5% payout rate can be beneficial if the CRUT is expected to last a long time. In the beginning, the distributions will be ordinary income since the funds contributed to the CRUT were pre-tax qualified plan or IRA funds. After all the qualified plan or IRA funds have been distributed, the nature of the payments will depend on the nature of the investment proceeds. The present value of the charity's remainder interest will be includable in the estate but offset by the estate tax charitable deduction.

This strategy works better for younger beneficiaries, since younger beneficiaries may live longer and may receive more distributions over their lifetime. However, a too-young beneficiary may be expected to live too long and the CRT will not meet the 10% remainder interest requirement. For example, at the current Section 7520 interest rate of 3% for May, a 26-year old beneficiary is too young.



Where does life insurance come into play with this strategy?

Life insurance on the life of the beneficiary can help protect against the risk of the beneficiary dying too soon. If a life payout is selected, the early death of the beneficiary will result in less going to the beneficiary and more going to the charity. Of course, a client leaving tax-inefficient assets (such as plan assets) to a CRT may also be interested in a WRT to replace the value of those assets.

Charitable Remainder Unitrust Trust (CRUT) — Example		
› One Life • Beneficiary Age 32 › Annual Payout › Sec. 7520 Rate: 3.00% › Fair Market Value of Trust: $1,000,000	1st year Distribution:	$50,000
	Charitable Remainder:	$127,020
	Charitable Deduction for Remainder Interest:	$127,020

Please keep in mind that CRTs are complex and can be costly to set up and administer. As always, clients need to review the pros and cons of any CRT strategies with their tax and legal advisors.

For more information, call Advanced Markets at 800.677.9696, option 8 or email advancedmarkets@columbuslife.com.

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