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Zero Estate Tax Plan Using Charitable Gifts and a Wealth Replacement Trust

Highlights of the Plan

Overview

One of the advantages of making gifts to a qualified charity is the availability of income, gift, and estate tax deductions. A qualified charity is a tax-exempt, non-profit corporation or trust that meets the requirements of IRC §501(c)(3). These organizations must be organized for religious, charitable, scientific, or some other purpose that serves the public good. Section 501(c)(3) organizations include churches, educational institutions, hospitals, medical research organizations, governmental units, certain organizations that receive a substantial part of their support from public contributions or membership fees, supporting organizations, and private foundations. Income tax deductions for gifts made to a qualified charity are governed by IRC §170. Gifts to qualified charities during life are governed by an unlimited gift tax charitable deduction, and gifts to qualified charities at death are governed by an unlimited estate tax charitable deduction.

Cash or property left to a qualified charity at death is eligible for an unlimited estate tax deduction. So, by setting up an estate plan that provides for all property in excess of the available unified estate tax credit, final expenses, and debts to be given to a qualified charity, a decedent can achieve a zero estate tax plan.

The Donor who makes substantial gifts to charity at death can also establish what has come to be known as a Wealth Replacement Trust (WRT) to replace the assets transferred to the charity for the benefit of the Donor's family. The WRT is simply an Irrevocable Life Insurance Trust (ILIT) that owns a life insurance policy on the life of the Donor with a face amount equal to the value of the property transferred to the charity. The net effect of using a Wealth Replacement Trust is to keep the Donor's estate from shrinking and give property to charity as a donation instead of to the government in transfer taxes. Through the insurance death benefit in the WRT, the family can achieve full wealth replacement. If desired, family members can use some of the cash in the WRT to purchase certain real or personal property from the charity, thus keeping certain heirlooms and homesteads in the family.

To coordinate with trust and will provisions and achieve the desired zero estate tax result, the Client's designated charity or charities should be named the death beneficiary of any "direct transfer" assets, such as assets in traditional and Roth IRAs and qualified pension, 401(k), 403(b), 457, and Keogh plans. These "direct transfer" assets also include securities and bank accounts, vehicle titles, death benefits from nonqualified deferred compensation, or any other right to transfer an asset to a specific individual at the Client's death.

One of the hallmarks of good financial planning is flexibility, and should the Donor have a change of mind about the charities selected, it is a relatively simple process to modify. Even if a Donor decides at some point to modify -- or even eliminate -- the charitable aspects of the planning, changes can be implemented.

Advantages to the Donor

1. The Donor receives an unlimited estate tax deduction for property transferred to charity at death.

2. By directing the executor to pay final expenses and debts, make distributions as designated in the Donor's will up to the available unified estate tax credit, and give the remaining estate assets to one or more qualified charities, the Donor's estate taxes are eliminated.

3. Through the purchase of insurance outside of the Donor's estate in a separate Wealth Replacement Trust, which is basically an irrevocable life insurance trust, the Donor can use the life insurance death proceeds replace all assets donated to charity at death.

4. Family members can use some of the cash in the Wealth Replacement Trust to purchase certain real or personal property from the charity, thus keeping certain heirlooms and homesteads in the family.

Advantages to the Charity

1. The charity receives substantial assets at Donor's death, which can be held for investment or sold for cash.

2. A deferred gift at death generally does not interfere with the Donor's current gifting.

Important Note: This material is for educational purposes only. In all cases, the approval of a client's legal and tax advisers must be secured regarding the implementation or modification of any planning technique as well as the applicability and consequences of new cases, rulings, or legislation upon existing or impending plans.