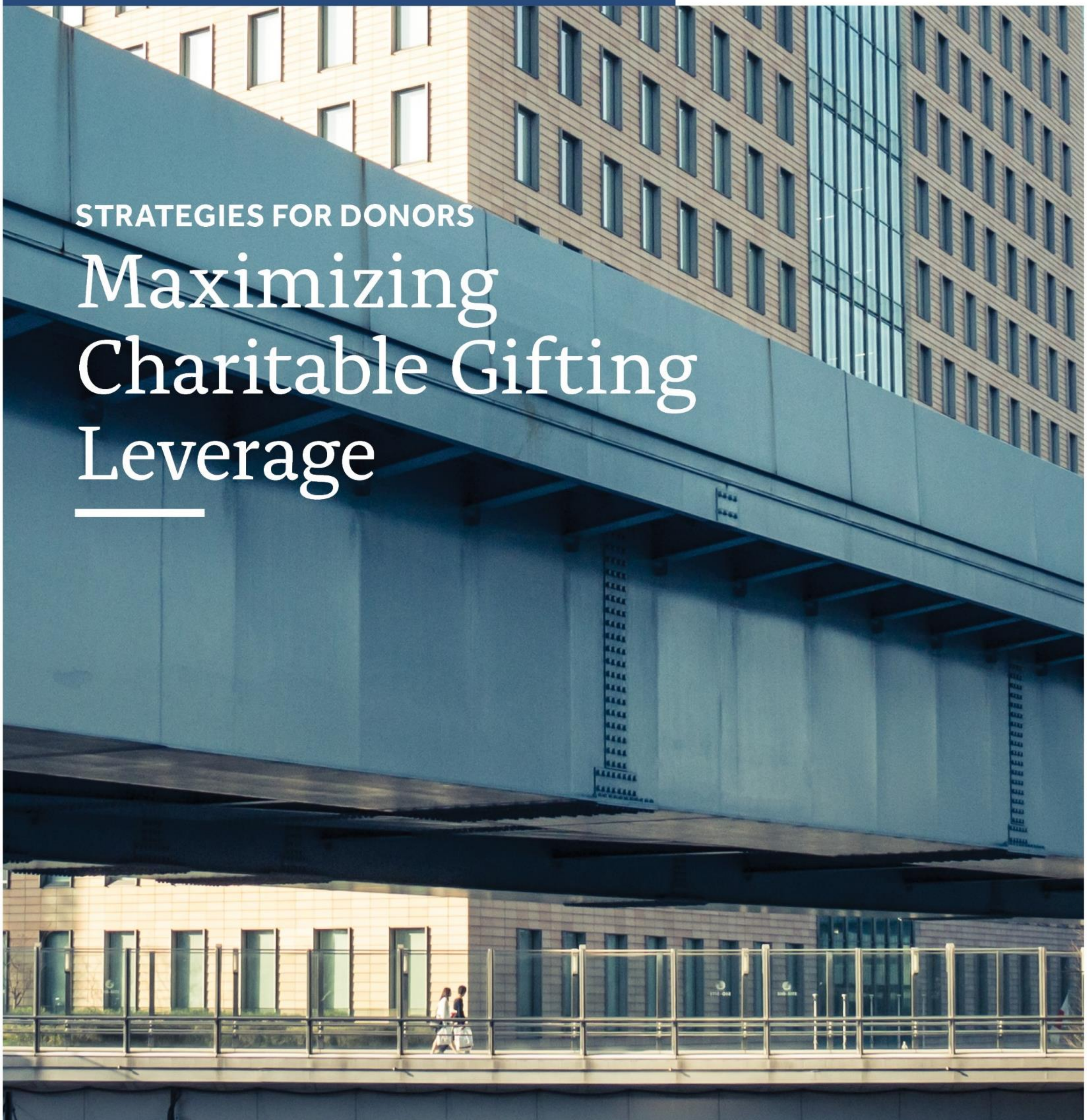
Charitable Corner

STRATEGIES FOR DONORS

Maximizing Charitable Gifting Leverage



Maximizing Charitable Gifting Leverage at Death

Upon the death of an individual, basically there exists only three available destinations for his/her assets. Those destination are to the individual's family, a government having a claim to that individual's assets, and charity. Tax considerations – income, gift, and estate – can be coordinated with charitable objectives to reduce amounts paid to government.

Examples of impact through charitable giving strategies

Where no estate or charitable strategy is implemented, a little more than two-thirds of the value of the assets at death typically will pass to the family, with the balance passing to the government in the form of taxes and fees, and nothing passing to charity.

> **Example**: Assuming a $30 million taxable estate (in 2023, when the applicable exclusion amount equals $12.92 million), government receives approximately $6.832 million, family receives around $23.168 million, and charity receives nothing.

If the decedent's last will and testament transfers assets to charity, the government's share is reduced; unfortunately, the family's share also is reduced.

> **Example**: Assuming a $30 million taxable estate (again, in 2023) with a charitable bequest equal to 10% of the estate (or $3 million), charity receives $3 million, government receives approximately $5.632 million, and family receives approximately $21.368 million.

If, however, assets can be accumulated outside of the taxable estate within an irrevocable life insurance trust, then result can be altered significantly.

> **Example:** Assuming a $30 million taxable estate (again, in 2023, and net of life insurance premiums paid), with a charitable bequest equal to 10% of the estate and a $5 million irrevocable life insurance trust, charity receives $3 million, government receives approximately $5.632 million, and family receives approximately $26.368 million.

Establishing an irrevocable life insurance trust to hold life insurance

An irrevocable life insurance trust (ILIT) can be a useful vehicle to hold life insurance policies outside of a person's taxable estate. When an individual has both control and ownership rights on a life insurance policy on his/her life, then the policy likely will be included in that individual's taxable estate.

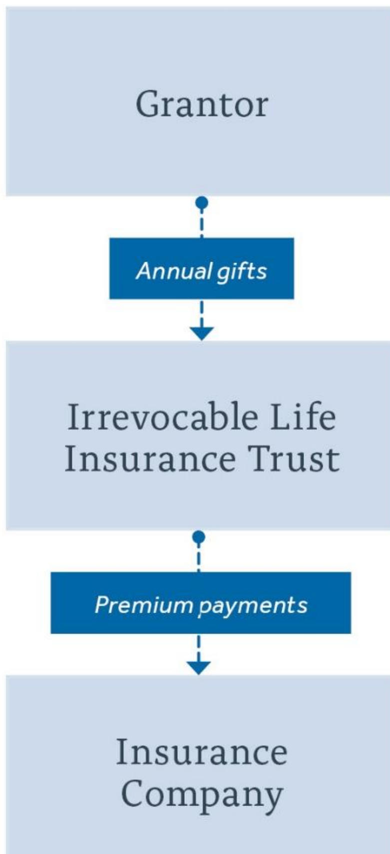
However, by relinquishing dominion and control of policies to an ILIT (essentially transferring ownership of policies to the ILIT), death proceeds may be removed from an individual's estate, reducing the estate tax obligation and providing numerous other benefits, such as asset protection to the beneficiaries and removal of life insurance value from the individual's taxable estate.

Upon the individual's death, the trustee will receive the life insurance proceeds income and estate tax free, if the ILIT has been administered properly. To pay estate taxes or other outstanding liabilities, insurance proceeds are usually either borrowed by the estate or used to purchase assets from the estate.

Typically, an ILIT is drafted and signed prior to the time any life insurance policy is issued and place into the trust. The ILIT may either apply for a new policy or an existing policy may be transferred to it.

- In the case of a new coverage, the ILIT purchases life insurance on the trust grantor's life and is owner and beneficiary of the policy.
    - Funds are typically gifted by the grantor to the trust to make premium payments.
    - To make non-taxable gifts, the gift may be applied towards the grantor's annual gift tax exclusion amount ($17,000 in 2023) or lifetime exemption amount ($12.92 million in 2023).

- An existing policy may either be gifted or sold to an ILIT.
    - If the policy is gifted to the trust, the grantor must live for at least three years after the gift is made or the policy will be brought back into the grantor's estate.
    - However, if the policy is sold to the trust for its fair market value, the 3-year rule does not apply.
    - The impact of the transfer-for-value rule cannot be ignored.
        - This rule stipulates that if a life insurance policy (or any interest in that policy) is transferred for something of value (e.g., money, property, etc.), a portion of the death benefit is subject to taxation as ordinary income.
        - This portion is equal to the death benefit minus the item(s) of value, as well as any premiums paid by the transferee at the time of the transfer.
- An operational diagram of an irrevocable life insurance trust is shown below.



As a result of the Tax Cuts and Jobs Act of 2017 (TCJA) it is expected that the estate, gift, and generation skipping transfer (GST) tax exemption amounts will increase to approximately $12.92 million per person (approximately $25.84 million for a married couple), effective in 2023. For assets transfers in excess of the applicable exemption amount and otherwise subject to such taxes, the highest applicable, federal tax rate remains at 40 percent. While the exemption amounts are indexed for inflation, current law provides for an automatic sunset of these increased exemption amounts after 2025. As a result, the exemption amounts available in 2026 and beyond could be reduced to a level provided under prior law ($5.49 million/single and $10.98 million/couple in 2017, indexed for inflation) absent further action by Congress. In addition, under different rates, rules, and exemption amounts (if any), there may be state and local estate, inheritance or gift taxes that apply in your circumstances. Please consult your own tax or legal advisor for advice pertaining to your specific situation.