How Can I Benefit from a Wealth Replacement Trust?

Charitable giving can be a rewarding experience by allowing you to both give and receive. To enjoy the benefits of charitable giving, you can utilize a variety of strategies.

The Basics of Charitable Remainder Trusts

To establish a charitable remainder trust, you transfer appreciated property to an irrevocable trust and designate the charity of your choice as the beneficiary of the trust. The property within the trust is then sold and reinvested to provide income. You retain a lifetime interest in the income generated by the trust, and when the trust expires at your death, the property within the trust is transferred to the charitable organization.

You are entitled to a current income tax deduction for the charitable gift, subject to certain limits. And because the property was sold within the charitable trust, you will not have to pay tax on any capital gains. This enables the full value of your property to be reinvested, which will increase the income generated by the trust. It also enables the charity to receive a larger gift.

If you have heirs, charitable remainder trusts have one major drawback: When the charitable trust terminates, the property within the trust is transferred to the charitable organization — rather than to family heirs. So while the charitable remainder trust offers many benefits, this strategy can effectively disinherit your heirs.

Replacing Gifted Assets

One effective solution to this situation could be a wealth replacement trust.

To create a wealth replacement trust, you use a portion of the income from a charitable remainder trust to buy a life insurance policy. You decide how much of the charitable gift to replace. You can buy enough insurance to replace only a portion of the property that will eventually pass to charity, or you may prefer to replace all of the property within the charitable remainder trust.

The wealth replacement trust is often designed so that upon the death of the second spouse, the death benefit of the life insurance policy goes to your heirs. These funds replace the property that passes to the charity from the charitable remainder trust.

And because the life insurance policy is owned by the trust, the proceeds of the policy will generally not be subject to estate taxes at either death.

An Appropriate Strategy?

If this strategy sounds interesting to you, there are a variety of considerations. The cost and availability of life insurance depend on factors such as age, health, and the type and amount of insurance. As with most financial decisions, there are expenses associated with the purchase of life insurance. Policies commonly have mortality and expense charges. In addition, if a policy is surrendered prematurely there may be surrender charges and income tax implications. Before implementing this strategy, it would be prudent to make sure you are insurable.

In many cases, the wealth replacement trust could be an appropriate way to preserve family wealth.

While trusts offer numerous advantages, they incur upfront costs and ongoing administrative fees. The use of trusts involves a complex web of tax rules and regulations. You might consider enlisting the counsel of an experienced estate planning professional and your legal and tax advisors before implementing such strategies.