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Allianz Life Insurance Company of North America

LIFE INSURANCE

Charitable remainder trusts and life insurance

Estate planning with highly appreciated assets

When designed properly, a trust can **help minimize estate and gift taxes.**

There are a variety of trusts that you can use to manage your assets and estate. When designed properly, a trust can help minimize estate and gift taxes – and it can help you control the timing and manner of distributions to your chosen trust beneficiaries. This piece covers two types of trusts: the **charitable remainder trust (CRT)** and the **irrevocable life insurance trust (ILIT)**.



It's possible that a significant amount of your net worth is held in an asset that does not provide you with a sufficient amount of income. And if your assets offer few or no dividend payments – like land or stock – you may be looking for income-producing alternatives. If this is the case, you may have an embedded gain that would force you to pay a large capital gains tax if you were to sell your assets.

The CRT allows you to: 1) remove the donated property from your gross estate; **2)** take a charitable income tax deduction for the charity's remainder interest in the initial transfer; and **3)** defer paying capital gains taxes on the appreciated property transferred to the CRT. By combining a CRT with a wealth replacement ILIT strategy, you can make the large charitable gift and replace the value of the donation with life insurance benefits for your heirs.

This material must be preceded or accompanied by the appropriate consumer product brochure (M-8119) or the "Understanding indexed universal life insurance" consumer brochure (M-3959).

Product and feature availability may vary by state and broker/dealer.

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Charitable remainder trust

Before you sign an agreement to sell your assets, you can transfer them into a charitable remainder trust (CRT) to avoid the immediate capital gains taxation. A CRT is a "split interest" irrevocable trust, designed to distribute income to at least one person. If you are charitably inclined, the remainder of the income is distributed to charity upon termination of the trust. Often, a donor creates the trust and transfers an appreciated asset to it.

Keep in mind: A transfer of assets to a CRT is an irrevocable gift – meaning that the assets would only be accessible under the terms of the trust.

In return, the CRT pays a series of income payments over a set number of years (determined by your attorney or tax advisor). The difference between the amount that went into the CRT and the present value of the stream of income determines what amount can be considered a charitable deduction. At the time of your death, your remaining trust assets would go to your trust beneficiary – the charity.

Benefits of a CRT

When the trust is set up properly, and for the right reasons, a CRT can:

- Benefit your favorite charity
- Give you an income tax charitable deduction for the value of the remainder interest going to the charity
- Defer your capital gains on the transfer of an appreciated capital asset to the trust
- Change an illiquid asset (i.e., one that is not readily salable) into a diversified mix of assets without immediate tax consequences to you
- Provide you with an income for life or a set term (up to 20 years)
- Reduce your estate tax bill (if you have an estate over the federal estate tax exemption amount)

WHICH ASSETS ARE IDEAL FOR FUNDING A CRT?

In general, the more the asset appreciates, the better the tax advantages will be. Some examples include:

- Publicly traded stock
- Closely held C corporation stock
- Land (farmland or vacation property that is no longer in use)

Cash can be appropriate as a gift to a CRT, but cash is not a capital gains asset, so the capital gains tax advantages are not present with cash gifts.

WHICH ASSETS ARE LESS IDEAL FOR FUNDING A CRT?

In general, the less your asset has appreciated or lost value, the fewer your tax advantages will be. Some assets – like qualified plans and individual retirement accounts (IRAs) – cannot be titled into a CRT and would need to be liquidated (and taxed) before transferring money into the CRT.

How does a charitable remainder trust work?

This hypothetical example is for illustrative purposes only.

Meet with an estate planning attorney and tax advisor to discuss whether a CRT is appropriate for you. If you decide to adopt a CRT, your attorney will draft the CRT documents. You can choose a CRT that pays income for life, or for a term of up to 20 years.

Step 1:

You irrevocably transfer assets to the CRT. The best choice of asset is a "low basis" (i.e., low original cost) capital asset – for example, a piece of real estate that has appreciated in value.

Step 2:

An appropriately drafted trust should allow the trustee of the CRT to sell the asset and reinvest in an income-generating portfolio to satisfy the required distributions.

Step 3:

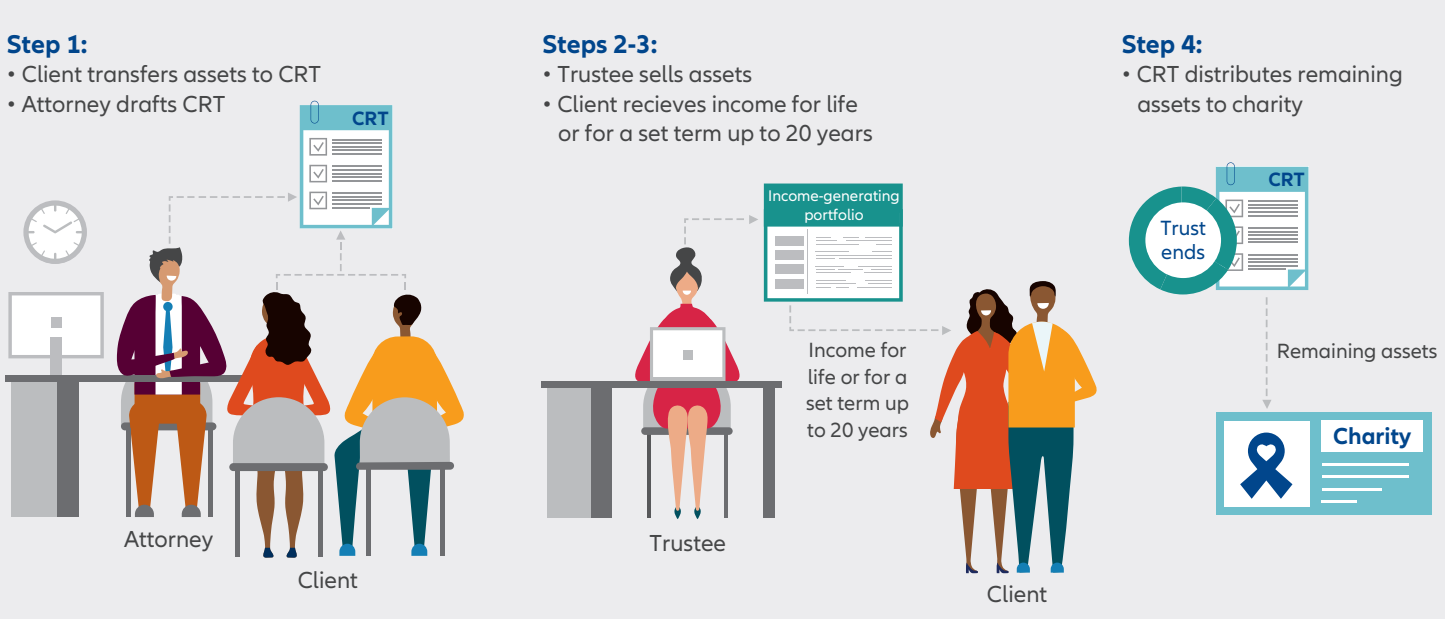
The trustee pays a specified income to you for life, or the set term of years. At the end of each year, the CRT will report these payments to you on a K-1 statement. You may have to report the income on your tax return. Each payment is taxed under a 4-tier scheme:

- **Tier 1** is the first money out; this is the CRT's ordinary income, and is taxed as ordinary income.
- **Tier 2** is the second money out; this is the CRT's capital gains, and is taxed as capital gain to you. At this point, you will pay the capital gains tax from when the CRT sold the illiquid asset you donated.
- **Tier 3** is tax-exempt income if the CRT holds any municipal bonds.
- **Tier 4** is tax-free return of basis.

Step 4:

When the trust ends at your death or after the term of years, the CRT distributes all the remaining assets to the charity that was designated in the trust. The value of the CRT in your taxable estate does not need to be included.

If you qualify as a high-income taxpayer, keep in mind that any taxable income from tiers 1 and/or 2 may be subject to the additional 3.8% Medicare surtax on net investment income.



Disadvantages of CRTs

- Your attorney will charge fees to set up the trust.
- Trustees may charge fees to administer the trust.
- The complexity involved with a CRT often requires ongoing consultation and advice from competent estate planning professionals and may result in additional costs.
- Transfers of assets to the CRT are irrevocable, and once completed, you will only receive income from the trust in the timing and amounts specified by the trust document. The transferred assets will no longer be available to you, should your situation change.

As an alternative, there are simpler and less expensive ways to benefit your favorite charity, such as:

- Outright donations of cash or assets to the charity during life
- Charitable bequests in your will of specific assets or cash
- Donations to a private or public foundation, or donor-advised fund

Additional considerations with CRT:

- CRTs are subject to a 5% rule that requires income be paid annually of at least 5% of the CRT principal, which could be an issue if trust income is not that high.
- CRTs are also subject to a probability test that requires a minimum amount be paid eventually to the charity from the CRT.
- Special CRT drafting by an attorney is required to provide potentially more flexibility and inflation protection.

Irrevocable life insurance trust

If the gift to the CRT helps to solve a potential current income problem, it may have caused a potential problem of leaving the children or grandchildren less than what you may have wanted. One potential solution is to use some of the CRT income in an irrevocable life insurance trust (ILIT), which would purchase a life insurance policy on one or both of the grantors who established the trust. At the time of their death, the ILIT would provide a death benefit outside of the estate that could be available for their beneficiaries.

An ILIT, named as the owner and beneficiary of a life insurance policy, provides your family with an income-tax-free death benefit when it is needed most. Though a clean bill of health and other financial qualifications are required (including funding the life insurance policy by paying premiums), the benefits of establishing an ILIT today can outweigh the drawbacks associated with establishing a trust and buying life insurance. Consult with an estate planning attorney and legal and tax advisors to discuss whether an ILIT would be appropriate for your situation. It's important to consider the advantages, disadvantages, and special tax implications before funding such a trust.

Benefits of an irrevocable life insurance trust (ILIT)

- If the ILIT is properly drafted, established, and administered, the death benefit paid to the ILIT should not be included in the taxable estate of the insured or subject to federal estate tax purposes (and depending on the state, may not be subject to state death taxes), as it would be if you owned your own policy.
- After your death, when money is needed most, life insurance provides death benefit proceeds to the trust and the proceeds are distributed pursuant to the terms of the trust.
- An ILIT is not subject to the probate process.
- The gifts to the ILIT will reduce the size of your estate, which will reduce federal (and potentially state) taxes.
- The ILIT can provide "control from the grave." The trustee will manage your assets after your death, making controlled distributions in the way that was indicated in the trust document. Therefore, you can potentially avoid having your children or other beneficiaries misuse the money after your death.

Disadvantages of ILITs

- Your attorney will charge attorney fees for consulting on the suitability of the ILIT, as well as writing the trust document.
- Trustees may charge fees to administer the trust.
- The complexity involved with an ILIT often requires ongoing consultation and advice from competent estate planning professionals and may result in additional costs.
- Premium costs of purchasing a life insurance policy owned by an ILIT may present challenges. Life insurance premiums may be more costly for a potential insured(s) who is/are in poor health. In some cases, life insurance may not be available if the client is uninsurable. Keep in mind that most life insurance policies require health and financial underwriting.
- Transfers of cash to the ILIT to pay the premium would be considered gifts subject to the federal gift tax. For 2026, each grantor can gift up to $19,000 for each trust beneficiary without having to fill out the gift tax form. You should consult with your estate planning attorney to assist with the potential gift tax issues of those transfers.
- In general, you are not able to use or access the life insurance policy cash values or other assets in the ILIT.
- The trust cannot be changed or revoked.

By combining the CRT and the ILIT, you can potentially create a scenario that can benefit your unique situation by generating potential income you need, while still leaving behind assets to benefit both your charity and your beneficiaries.



TO DETERMINE SOLUTIONS FOR YOUR UNIQUE SITUATION, work with your estate planning attorney and a legal or tax advisor to draft the trusts, and your financial professional to identify what life insurance products may be suitable.

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