The Principal Financial Group®

Wealth Replacement Trust

Why wealth replacement trusts?

Many individuals may hesitate to make substantial charitable gifts because they fear the gift may compromise the financial security of loved ones. The wealth replacement trust (a.k.a. capital replacement trust) allows individuals to accomplish both goals: providing for beneficiaries and giving to a favored charitable organization.

How does it work?

The wealth replacement technique uses a charitable remainder trust, a life insurance policy, and an irrevocable life insurance trust. The donor sets up a charitable remainder unitrust (CRUT). The unitrust pays income to the donor for life, or for a term of years not to exceed 20. The donor receives an income tax deduction for the present value of the charity's remainder interest.

The donor also sets up an irrevocable life insurance trust (ILIT) in which the donor/insured has no interest or incidents of ownership. The trustee purchases a life insurance policy on the life of the donor with death benefits at least equal to the value of the property transferred to the CRUT.

The donor uses the income payments from the CRUT to make annual gifts to the irrevocable life insurance trust, which may be sheltered in whole or in part by the gift tax annual exclusion. The trustee then uses those funds to pay the annual premiums on the life insurance policy.

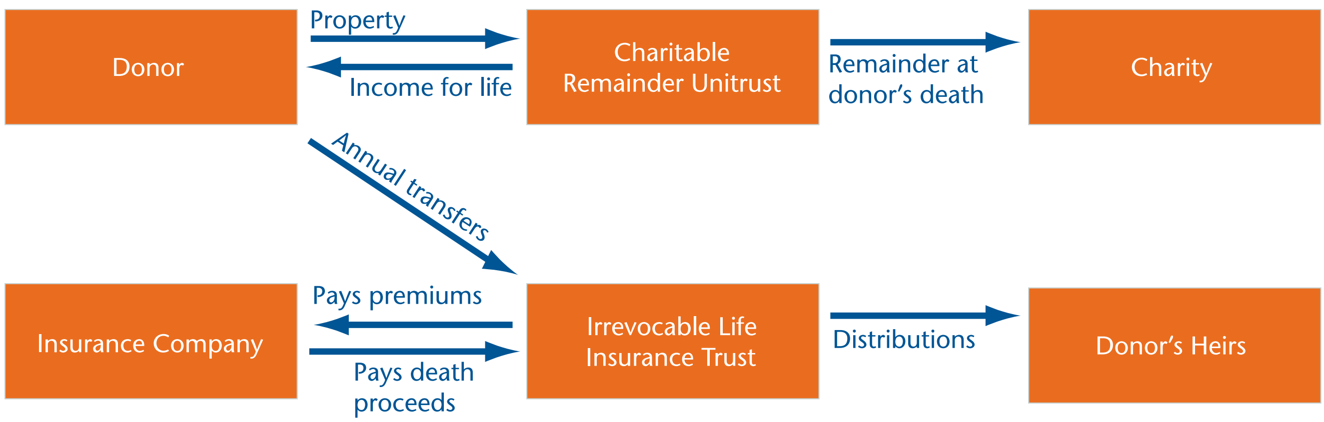
With a CRUT that pays income to the donor for life, at the donor's death, two things happen. First, the charity receives a substantial gift at the termination of the CRUT. Second, the insurance trust receives the proceeds from the life insurance policies, and uses them as directed for the donor's heirs.

What are the benefits?

The donor receives several benefits by setting up a wealth replacement trust:

- Assures the financial security of heirs by using life insurance to replace assets donated to charity.
- Makes a substantial charitable gift to a designated charitable organization.
- Defers capital gains tax on the transfer of appreciated property to the CRUT.
- Secures a sizable income tax charitable deduction in the year the CRUT is funded, based on the present value of the charity's remainder interest.
- Removes property transferred to charity and life insurance proceeds from his or her gross estate for federal estate tax purposes, if ownership is structured properly.

How wealth replacement works



- The donor transfers long-term appreciated property to a charitable remainder unitrust (CRUT) and receives a federal income tax deduction for the present value of the charity's remainder interest, subject to limitations.
- The CRUT pays the donor an income for life, or for a term of years not to exceed 20.
- The trustee of the CRUT can sell an appreciated asset without paying capital gains tax.
- The donor uses the income from the CRUT to make gifts to an irrevocable life insurance trust (ILIT). The trustee of the ILIT can use the gifts (after the beneficiary's right of withdrawal has expired) to help pay premiums for a life insurance policy on the donor's life owned by the ILIT. The initial face amount of the policy is often the fair market value of the property transferred to the trust.
- When the donor dies, the ILIT receives the policy death proceeds, and the charity receives the property in the CRUT.
- Result: Donor receives a current income tax charitable deduction and increased cash flow for life. Donor's heirs are "made whole" with life insurance that replaces the donated capital, and the donor makes a significant gift to charity.

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