



Charitable Giving with Employer Stock

*“Give to your favorite charity,
avoid capital gains taxes,
receive an income stream,
and provide for your family.”*

We offer you this concept piece to help you understand how life insurance can be used with charitable giving strategies. This material contains references to concepts that have legal, accounting and tax implications. It is not intended as legal, accounting or tax advice. Consult your own attorney and/or tax advisor for advice regarding your particular situation.

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Do you identify with the following?

- ◆ You recently retired or changed jobs and received or are eligible to receive a lump sum distribution that includes employer stock from an employer-sponsored plan.
- ◆ You want to avoid cashing in the employer stock and paying capital gains taxes.
- ◆ You would like an additional income stream.
- ◆ You would like to benefit your favorite charity.

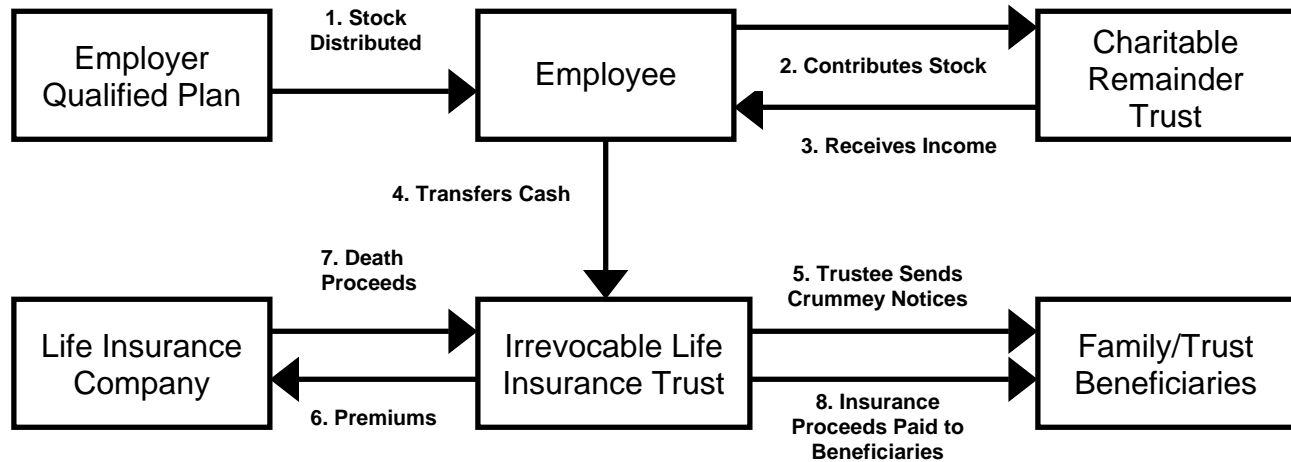
If so, you may want to consider contributing the employer stock to a charitable remainder trust (CRT) that will generate an income stream to you.

And if ...

- ◆ You would like to make your family whole by replacing the value of the employer stock given to charity, and
- ◆ You want to keep the value of the replacement asset outside of your estate,

Consider establishing an irrevocable life insurance trust (ILIT) to own life insurance with proceeds that approximate the value of the gifted stock.

Structure of a Charitable Remainder Trust with Employer Stock



1. Employee receives a lump sum distribution from the employer-sponsored qualified retirement plan that includes employer stock. Employee pays income tax on the cost basis of the shares rather than the current market value of the stock at time of distribution. The balance of the stock value [net unrealized appreciation (NUA)] is taxed at capital gains rates when the stock is sold. Employee may roll over the portion of the qualified plan account that does not constitute employer stock.
2. The employee establishes a charitable remainder trust (CRT) and gives the employer stock to the CRT. The present value of the remainder interest passing under the trust generally qualifies for a charitable income tax deduction (the amount of the deduction varies).
3. The trustee sells the stock, reinvests the proceeds, and pays an income stream to the employee and/or the employee's spouse beginning either immediately or in the future. No capital gains tax is due on the sale.
4. Employee establishes an irrevocable life insurance trust and gifts cash to the trust. The trustee will purchase and own a life insurance policy on the life of the employee and/or the employee's spouse. (A CRT often provides an increased income stream, part or all of which can be used to purchase the insurance.)
5. To qualify the gifts for the gift tax annual exclusion (to avoid gift tax), the trustee sends notices to the beneficiaries allowing them to withdraw their shares of the gift. These notices are called "Crummey" notices.
6. After the trust beneficiaries allow their withdrawal rights to lapse, the trustee pays the premiums for the life insurance to the life insurance company.
7. At the death of the insured, the life insurance company pays the death proceeds to the trust.
8. The trustee pays the life insurance proceeds to the beneficiaries as provided by the terms of the trust. Properly established, the life insurance proceeds will be free from both estate taxes and income taxes. [IRC § 101(a)].

What are the alternatives?

The employee rolls over the stock to an IRA:

- ◆ There are no income taxes at the time of distribution, but the opportunity for long-term capital gain treatment of the NUA portion is forfeited.

The employee receives the stock and sells it:

- ◆ He/she will be taxed in the year of distribution on the cost basis of the stock in the plan.
- ◆ He/she will pay long-term capital gains taxes on the difference between the cost basis and the sales price of the stock (NUA), only upon the sale of the stock.

The employee holds the stock until his death:

- ◆ The cost basis value of the stock is subject to income tax at time of distribution from the plan. When the heirs sell the stock, they will pay capital gains tax on the value attributed to NUA because this portion of the stock value does not receive a step-up in basis at the employee's death. Any subsequent growth receives a stepped-up basis.

The employee gives the stock to a charitable remainder trust:

- ◆ The employee is taxed in the year of distribution on the cost basis of the stock, but is permitted a charitable income tax deduction for the present value of the remainder interest passing under the charitable remainder trust. No capital gain tax is payable upon the sale by the trust, because the CRT is tax-exempt.
- ◆ The CRT pays an income stream to the employee, starting immediately or in the future.
- ◆ The employee can establish a wealth replacement trust funded by life insurance to provide his or her family with assets to replace the value of the donated stock. The life insurance death benefit is generally received free of both estate and income taxes under IRC §101(a).

This chart is a comparison of four techniques: (1) rolling over the stock, (2) selling the stock, (3) leaving it to heirs, and (4) transferring it to a CRT.

	No NUA Election	Net Unrealized Appreciation (NUA) Election*		
	Roll Over Stock to IRA	Plan distributes stock during employee's lifetime	Plan distributes stock to heirs at employee's death	Gift to CRT & Wealth Replacement ILIT
Income Tax Implications	None at time of rollover, but NUA election opportunity is forfeited. Future distributions fully taxable at ordinary income rates.	Ordinary income tax in year of distribution to extent of basis. Long term capital gain on NUA when sold. Subsequent gain subject to long or short term gain.	Heirs pay ordinary income tax in year of distribution to extent of basis; long term capital gain on NUA portion when sold. Any subsequent gain receives stepped up basis.	Ordinary income tax in year of distribution to extent of basis. No tax on NUA portion in hands of the CRT.
Charitable Income Tax Deduction	None	None	None	Yes. Present value of the remainder interest passing to the charity.
Income Stream to Employee	Stock may be held or sold inside IRA to create future income stream. Proceeds grow tax-deferred.	After-tax proceeds could be reinvested to create an income stream.	None.	Yes. CRT pays income to the employee and can start immediately or in the future.
Estate Taxes	Yes. Entire account proceeds are included in IRA owner's estate.	Yes. Proceeds still owned by employee are included in his estate.	Yes. Fair market value of stock is included in employee's estate.	No. Proceeds are removed from the employee's estate when gifted to CRT.
What does your family receive?	Proceeds left over after ordinary income tax and estate taxes.	Proceeds left after capital gains tax and estate taxes.	Stock, reduced by income tax on basis, capital gains tax on NUA, and estate tax.	Life insurance death proceeds, generally free from estate and income taxes [IRC §101(a)].

* The benefits of an NUA election depend on a number of factors, including your age, investment horizon, and current and future tax rates. Consult your own attorney and/or tax advisor or advice regarding your particular situation.

Benefits to the Employee:

- ◆ The employee can avoid capital gains tax on the NUA (net unrealized appreciation) portion of a distribution of employer securities from a qualified plan. (NUA is the difference between the cost basis and the fair market value at distribution.) The employee recognizes income only to the extent of the average cost basis of the employer stock.
- ◆ The employee generally is entitled to a charitable income tax deduction for the present value of the remainder interest his/her favorite charity will receive from the charitable remainder trust (CRT).
- ◆ The employee has made a valuable contribution to his favorite charity, while maintaining an income stream for himself and/or his spouse.
- ◆ The income stream can start immediately or at some future date, depending on how the CRT is set up.
- ◆ The stock is no longer included in the employee's estate for federal estate tax purposes, thereby lowering any estate tax that may be imposed on the stock.
- ◆ The employee has replaced the value of the stock given away with life insurance, which will be paid to the beneficiaries of his irrevocable life insurance trust. Properly structured, the life insurance proceeds used to replace the stock given to the CRT will be free from estate and income taxes. [IRC § 101(a)]

Tax Considerations:

- ◆ Special tax rules apply when a lump sum distribution from a qualified plan includes securities of the employer corporation. In general, the growth in the value of the employer securities that occurs between the time the securities were originally placed in the employee's qualified plan account and the time of distribution from the qualified plan (referred to as net unrealized appreciation or NUA) is not taxed at the time of distribution provided that it is part of a lump sum distribution. If the employee makes an NUA election, taxation of the NUA is postponed until the stock is sold. It is then taxed at long-term capital gains rates.
- ◆ If the employee holds the stock at his death, the stock does not receive a step-up in basis to the extent that the employee has benefited from the NUA tax exclusion. The NUA will constitute income in respect of a decedent to the heirs and will be subject to long-term capital gains tax when heirs sell the stock. The stock receives a stepped-up basis only to the extent the stock appreciated in value after the distribution from the qualified plan.

- ◆ The employee does not recognize any immediate taxable income or capital gain from the act of contributing the stock to the CRT.
- ◆ S corporation stock cannot be owned by a CRT. Consequently, while an NUA election may be possible, a CRT gift is not possible with stock from an S corporation.
- ◆ The amount of the deduction for gifts to a charitable remainder trust varies depending on a variety of factors including the type of gift and the type of charity, the current “7520 rate,” the age of the donor, the ages of the income beneficiaries of the CRT, and whether the trust pays income for life or for a term of years.
- ◆ The income stream paid to the employee by the CRT is subject to income taxes as it is received. The nature of the income (ordinary income or capital gains) is determined according to a four-tier system of accounting inside the CRT.
- ◆ Your legal and/or tax advisors may want to review Private Letter Rulings 200038050, 200038052 and 200038057.