Creative Applications of Life Insurance in Charitable Lead Trusts

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The time is right for the review of Charitable Lead Trust strategies in your clients' portfolios. That doesn't mean these strategies are only for clients with six-figure tax woes; clients appreciate CONTROL over their monies, and a well-structured and appropriately-funded CLAT or CLUT can go a long way in helping clients fully realize the value of their social capital.
Below are three examples of Charitable Lead Trusts implemented for three divergent clients in order to accomplish varying goals of philanthropy as well as tax mitigation and long-term asset accumulation. All examples were funded with cash, Modified Endowment Contract limit-designed whole life insurance, and/or real estate. The tax-deferred nature of life insurance and real estate make those assets ideal for CLT structures. While municipal bonds have long been a favored asset, in these times of ultra-low interest rates with an almost guaranteed increase in rates in the future, their inclusion in CLT structures at this juncture seems unwise due to principal risk and the low income they currently generate.

Example A

Client A is a high-income-earning business owner aged mid 50's, who is already philanthropic, but was not receiving much tax benefit from annual contributions, due to a phase-out of deductions based on a seven figure income (currently, phase-outs are suspended); annual charitable donations of $25,000 did not significantly reduce the taxpayer's $1,000,000+ income. We recommended and implemented a Grantor Reversionary 20-year or Shorter (based on the life of the spouse) CLUT designed to be funded over the next four years with a maximum of $2,000,000 in contributions. The client wanted to increase charitable giving and the design implemented created both the assets to do so as well as substantial tax deductions for the client in each year contributions are made. To date, the client has funded approximately $1,000,000 dollars to the CLUT, resulting in approximately $400,000 in tax savings thus far. The tax savings have been used to invest in real estate; considerations whether the client will fund the remaining contributions in cash or real estate are being discussed currently.
The cash contributions to the CLUT fund a (modified endowment contract) MEC-limit $5 million 20-year-pay whole life policy on the spouse, age 47, designed to be paid over the next five years before MEC status would be reached, including distributions for the annual payments to charity. The CLUT is the owner and beneficiary of the policy and of all assets will revert back to the grantor at the termination of the trust, at a date when the client anticipates retirement. The guaranteed cash values and subsequent guarantees attributed to the dividends once accrued are a perfect source of charitable payments without further tax ramifications. Additionally, the possible addition of rental real estate provides another source of funding for charitable payments as well as another source of funding for the life insurance policy.

Example B

The clients are a couple with no children who have recently taken an early retirement (he is 56, she is 49) and are very philanthropic. During their working years, they regularly gave between $50,000 and $75,000 per year. As we were planning their retirement, they expressed a desire to be able to continue their level of giving during retirement as well as create a large endowment for their charity at the second death.

We implemented a Grantor Reversionary seven-year or shorter (each based on the other's life) CLTs for each of them, his funded with an existing life insurance contract (approximately $600,000 cash value), and hers funded with cash (approximately $400,000), which we then used to purchase a MEC limit $2 million 20-pay whole life policy. The CLTs helped to offset the taxes due on the sale of a practice, and the proceeds of the practice are the funds they are using for the next three years until qualified plan assets can be accessed freely. Additionally, the CLTs are continuing the $50,000 charitable gifting they wanted for the next seven years. Once the two CLTs end, the assets will revert back to the grantors and can supply additional income in retirement as well as significant death benefit (minimally $2,000,000+ if cash value is used in retirement) for their charity at the second death. For this couple, the creation of an endowment for the charitable causes they love has given them a sense of joy beyond words.

While there was no new insurance sale for his CLT, we were the original writers of that contract, and we believe it has been put to its highest multiple uses; death benefit protection for surviving spouses as well as, ultimately, the charity, tax-favored cash accumulation, guarantees of principal to protect charitable payments, and a tax deduction to create more spendable income in the couple's early retirement years.

Example C

The client is a successful 39 year old business owner who gives approximately $20,000 annually to a variety of charities. She has a $2 million business that is growing rapidly, and she is very frugal with her monies. She may want to retire at age 50, so we designed a CLT to terminate soon thereafter. We recommended and implemented a Grantor Reversionary 12-year or shorter CLUT which allowed her to create enough deduction for her current year of contribution and an additional projected 4 years of carry forward deduction. As it turns out, she is earning additional revenues over projections, so she is continuing her cash contributions. The CLUT holds cash and a MEC limit $10 million 20-pay policy, which is funded as much as possible each year to get the maximum cash into a guaranteed, tax-deferred accumulation environment which allows her to continue her philanthropy. While she has no children of her own, she has a large extended family for whom she provides some support and will likely continue to provide additional support in the future. Therefore, the ability to have control of significant death benefit in the future is paramount, as well as liquidity once the trust terminates.
These examples are specific situations in which a charitable planning strategy helped to amplify the benefits to the donor as well as to their charities. Each donor was able maintain control of their social capital, and create more personal wealth and philanthropic giving—all with products and structures that contain implicit guarantees. The best of all possible solutions: Give, Get and Keep instead of Pay, Owe and Lose!

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