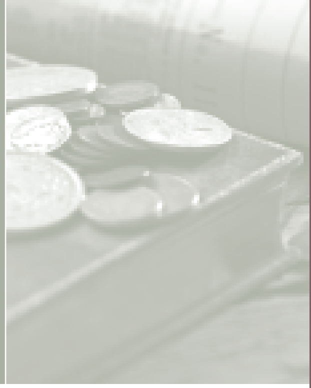
John Hancock
LIFE INSURANCE





# *Success Strategy*
# The Charitable Lead Trust

## CHARITABLE GIFTS THAT PRESERVE PERSONAL WEALTH

Making charitable gifts to a Charitable Lead Trust (CLT)[1] can help you to achieve your charitable objectives and to preserve your personal wealth. A CLT can provide you substantial gift tax savings and reduce your taxable estate, while providing a gift of an income stream to the charity. And a CLT coupled with life insurance can help you to leverage the wealth you transfer to your family.[2]

## HOW A CHARITABLE LEAD TRUST WORKS

Instead of making a charitable gift directly to charity, you can make the gift to a CLT to benefit a specifically named charity, or a specific cause. Because the CLT is a split-interest trust, both you and the charity benefit from the trust.

A CLT is set up for your lifetime or for a period of years. However, the charity receives an income stream from the trust for the trust term. At the end of the term, you, or your family, will receive the balance of the trust assets.

## TYPES OF CHARITABLE LEAD TRUSTS

**Non-Grantor CLT.** When a non-grantor CLT is used, the trust balance is typically transferred to your heirs. The transfer of the trust balance is considered a lifetime gift and is subject to gift tax. However, you can receive a charitable gift tax deduction that is based on the present value of the income payments made from the trust to charity. This deduction essentially discounts the gift tax. Therefore, a non-grantor CLT can help you to effectively manage gift and estate taxes. No current charitable income tax deduction is available, however.

**Grantor CLT**. A charitable income tax deduction is available only for CLTs that are established as grantor trusts. That is, you, as grantor, will be responsible for the trust's income taxes. However, the taxes may be offset by a deduction that is available to you for the income payments made from the trust to the charity. The deduction is subject to limitations based on the type of asset transferred, the type of charity to benefit, as well as your adjusted gross income (AGI). Although less frequently used than a non-grantor CLT, a grantor CLT can be a particularly helpful tool in large income tax years. Like the non-grantor CLT, it may be possible to take a charitable gift tax deduction if the trust balance is to be transferred to your heirs.

## **CASE STUDY:** CHIP AND CARLA WORCESTER

Chip (60) and Carla (60) Worcester have an estate worth $15,000,000 and are concerned about how much of the estate will be depleted by transfer taxes. They like the idea of helping a charity.

They have learned about some of the benefits of establishing a CLT. They have decided to transfer $1,000,000 of highly appreciated real estate as well as $1,000,000 of cash to a lifetime Charitable Lead Annuity Trust (CLAT) with a 7% income interest payable to the Native American Foundation, a public charity. Their children will receive the balance of the trust assets at the end of 10 years, the end of the trust term. Although a charitable income tax deduction is not available when the asset is transferred to a non-grantor CLT, the Worcesters can take a charitable gift tax deduction of $1,081,038, assuming a current federal rate of 5%. Effectively, this deduction discounts the value of the gift made to the children significantly, especially when federal rates are low. Therefore, the value of the current gift is $918,962, not $2,000,000. The gift is not subject to gift tax because the Worcesters can use part of their available lifetime gift tax exemption to cover the amount of the gift. If the trust actually earns a net 8%, the value of the trust in year 10 would accrue to $3,207,153. This means that $2,288,191 ($3,207,153 – $918,962) has completely avoided gift and estate taxes.

The trust can also use a portion of the assets to purchase life insurance and increase the amount ultimately transferring to the children.[3] The trustee can take $20,000 per year assuming ten years of annual premium payments from of the cash in the trust to purchase a John Hancock Protection SUL-G policy with a guaranteed death benefit of $764,576. In this case, by year 10, $2,880,369 ($3,799,331 – $918,962) has escaped gift and estate taxation. A comparison of the net amount transferred to heirs with and without life insurance is as follows:

| YEAR | WITHOUT LIFE INSURANCE (Trust grows at 8% net) | WITH LIFE INSURANCE (Trust balance grows at 8% net) | DIFFERENCE |
|---|---|---|---|
| 1 | $2,060,000 | $2,814,076 | $754,076 |
| 5 | $2,421,499 | $3,119,473 | $697,974 |
| 10 | $3,207,153 | $3,799,331 | $592,178 |
| 20 | $7,721,514 | $8,248,716 | $527,202 |

This example assumes the use of a John Hancock Protection SUL-G life insurance policy with a guaranteed annual premium of $20,000 and that no policy loans and withdrawals are taken. A current hypothetical crediting rate of 5.05% is also assumed. Income that is generated after the 10 year trust term is assumed to be reinvested thereafter in a trust to benefit the children at the death of the surviving spouse.



1. Trusts should be drafted by an attorney familiar with such matters in order to take into account income and estate tax laws (including the generation-skipping transfer tax). Failure to do so could result in adverse tax treatment of trust proceeds.
2. Income generated from a CLT should not be used to purchase the life insurance or the CLT may be characterized as a grantor trust, in which case the trust principal (including any life insurance) will be includible in the taxable estate. Trust income will also be taxable to you if the trust is considered a grantor trust. See IRC §671-679.
3. The Tax Increase and Prevention Reconciliation Act of 2005 (TIPRA) created new code section IRC 4965 which imposes an excise tax on tax-exempt organizations that engage in prohibited tax shelter transactions for tax years ending after May 17, 2006. "Prohibited tax shelter transactions" include any reportable transaction, any listed transaction or any transaction that is "substantially similar" to one of those. The excise tax is imposed whether or not the transaction is determined to be abusive.



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