

GOLD – REASON #1

FINANCING LIFE INSURANCE PREMIUMS TO ENHANCE CHARITABLE GIVING

Many wealthy clients make significant charitable gifts, especially at death, as part of their estate plan. These gifts directly benefit their favorite charities, and indirectly benefit society as a whole. A secondary but by no means insignificant benefit is that charitable gifts at death reduce estate taxes, which can reach as high as 45% or 55%.

Today, however, many clients face the prospect of not being able to complete the charitable gifts they planned only a few short years ago. Drastic drops in the stock market and the real estate market and perhaps even financial fraud have left many clients with vastly smaller estates. Consequently, some may wish to change their estate plan, albeit temporarily, to put family first by reducing or eliminating those charitable gifts – at least until the time when their estate has recovered from financial setbacks. Fortunately, there is a strategy that can help them fulfill their original charitable desires, and in some cases, promises. This strategy can provide a short-term “lift” to their charitable-giving plan that, in essence, buys them time for their estate values to recover, so their original plan is back in place. Let’s look at an example.

THE PROBLEM

Mr. Smith, age 72, spends his golden years between his home in New England and his vacation home in the Southwest. Although his wife recently passed away, he is financially well-off because she left him \$2,000,000 in trust, and \$10,000,000 directly to him. After his wife’s death, he met with his advisors and developed an estate plan under which one-half of his estate (not including anything in the trust) would be left to his three children, while the remaining one-half of his estate would be left to four local charities. Potential estate taxes are expected to be covered by life insurance already held in an irrevocable trust. Unfortunately, since his wife’s death, the value of his estate has dropped by 50%. Mr. Smith is now concerned that his children will be “short-changed” because instead of splitting \$10,000,000 with the charities, they will be splitting only \$5,000,000. Yet at the same time, he still wants to make substantial gifts to those charities. He has once again consulted his advisors to see if they can help solve this dilemma.

THE SOLUTION

Mr. Smith’s advisors have suggested a plan under which life insurance is used to replace the lost value of his estate. Because they expect the value of his investments, his homes and other financial assets will eventually recover, it is suggested that the amount of insurance decrease over time, so that as his estate grows, the replacement amount decreases. The goal is to have the combination of asset values and death benefit equal \$10,000,000, his original estate.

His advisors have calculated that his \$5,000,000 estate will grow to approximately \$10,000,000 after eight years, assuming a 9% growth rate. Consequently, his insurance need is only for eight years. Mr. Smith will establish a trust to purchase and hold the life insurance (ILIT). Because his income dropped significantly along with the value of his assets, Mr. Smith would like a way to reduce his immediate out-of-pocket expense for the insurance. It is recommended that Mr. Smith purchase life insurance through the Gold Program offered by Concord Capital.

The GOLD Program provides a declining death benefit feature, with low cash outlays by the insured. Under this program, a third party posts cash as collateral, on behalf of Mr. Smith's ILIT, in favor of Concord Capital for 100% of the loaned amount. The ILIT incurs two fees which are payable from the death benefit. The first is a collateral fee which is levied on an annual basis on the total cash collateral posted. This fee is approximately 9% of the collateral posted per annum. The second fee is a "make-whole" amount, which represents the opportunity cost of funding collateral to the premium finance lender for 8 years. At Mr. Smith's age, the annual premium is \$451,000 for a \$8,000,000 death benefit. The net death benefit to the ILIT is equal to the face amount of the death benefit, less the premium finance loan, the accrued collateral contingent fee, structuring fee, arrangement fee and the make-whole amount. Mr. Smith is not required to post any collateral, but he is required to make a contribution to the ILIT of approximately 4% of the annual premium, which the ILIT pays to Concord to reduce the loan.

This table illustrates how the Gold Program can work for Mr. Smith.

Year	Mr. Smith's Age	Mr. Smith's Annual Contribution to ILIT	Gross Death Benefit	Amount Payable to Collateral Provider	Net Death Benefit To ILIT	Projected Value of Estate	Total Estate
1	72	\$18,040	\$8,000,000	\$1,777,575	\$5,600,818	\$5,000,000	\$10,600,818
2	73	\$18,040	\$8,000,000	\$1,765,175	\$5,152,142	\$5,450,000	\$10,602,142
3	74	\$18,040	\$8,000,000	\$1,712,060	\$4,718,738	\$5,940,500	\$10,659,238
4	75	\$18,040	\$8,000,000	\$1,668,695	\$4,249,102	\$6,475,145	\$10,724,247
5	76	\$18,040	\$8,000,000	\$1,600,650	\$3,775,651	\$7,057,908	\$10,833,559
6	77	\$18,040	\$8,000,000	\$1,524,430	\$3,279,447	\$7,693,119	\$10,972,567
7	78	\$18,040	\$8,000,000	\$1,449,680	\$2,746,420	\$8,385,500	\$11,131,921
8	79	\$18,040	\$8,000,000	\$1,807,794	\$1,746,633	\$9,140,196	\$10,886,828

SUMMARY

By adding premium-financed declining insurance to his estate plan, Mr. Smith is able to:

1. Use tax-efficient life insurance to instantly restore his testamentary charitable gifts,
2. Avoid paying immediately out-of-pocket for substantial premiums, and
3. Leverage the benefits of life insurance by borrowing money to pay premiums.

NEXT STEPS

To help find clients that fit the profile described in this strategy:

1. Look for clients with planned charitable giving,
2. Consult with clients to determine if their charitable giving should be restored with life insurance,
3. Contact your aggregator for a premium financing illustration.

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