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NO COMMENTS

LIFE INSURANCE & CHARITABLE GIVING

Here are four ideas for using life insurance as a charitable tool:

1. Name Charity as the beneficiary of an existing life insurance policy

Donor can name Charity as beneficiary of an existing life insurance policy. Simple! Also, it's revocable; Donor can always change her mind.

Tax treatment. In this scenario, there can't be an income tax charitable deduction. At death, the death benefit may possibly be included in the estate, but if so, the estate receives an offsetting estate tax charitable deduction.

2.A. Assigning ownership of an existing term policy

Donor can transfer ownership of a policy to Charity, and Charity can then name itself as beneficiary of the policy. Donor can make donations in the amount of premium payments, and Charity can then pay the premiums.

Tax treatment. Income tax charitable deduction for the gift of such a policy is limited to value on date of gift; very likely to be negligible. However, Donor would be entitled to charitable deduction for donations made to Charity to cover premium payments, subject to the usual charitable deduction limits.

2.B. Assigning ownership of an existing whole life policy

If Donor transfers ownership of an existing whole life policy or other nonterm policy to Charity, Donor is making a gift of the cash surrender value of the policy to Charity for which an income tax charitable deduction should be available (subject to the usual charitable deductions restrictions).

Premium still due. As with the term policy, if Donor intends to continue paying the premiums, donations to Charity can be made each year which Charity can use to pay the premiums. These annual donations also would qualify for income tax deductions, subject to the usual restrictions for charitable contributions.

Paid up policy. Of course, if Donor gifts a single-premium or paid up policy there will be no future payments due, thus eliminating the need for annual contributions to cover additional premiums.

3. Offsetting a gift of [other] property.

Suppose Donor has assets she would be willing to gift to Charity, but is concerned such a gift might reduce the inheritance of Donor's family, an option might be to use life insurance to “offset” the gift. Donor can give assets to Charity now, while purchasing life insurance with a face value equal to the value of the charitable gift and naming her estate (or family members directly) as the beneficiary of the new policy. The benefit to Donor is that she receives an income tax deduction for the charitable gift. In addition, if a properly structured insurance trust is used to purchase the new policy on Donor’s life, Donor’s heirs may end up better off than if they had received the original assets given to charity, as the insurance proceeds will not be included in Donor’s taxable estate.

4. Funding a Charitable Remainder Trust

Going a step further, a Charitable Remainder Unitrust (CRUT) can be created to which appreciated assets could be contributed. The CRUT would pay Donor a fixed amount each year until Donor’s death, after which the assets remaining in the CRUT would be distributed to Charity. Donor could use all or a portion of the annual CRUT distributions to fund the insurance policy placed in the insurance trust, thereby offsetting the reduction in Donor’s estate created by the charitable gift.

5. Issues to consider re gifts of life insurance

5.A. Irrevocable?

If Donor wishes to retain ownership of the life insurance policy and simply name Charity as beneficiary, the beneficiary designation should not be irrevocable or Donor will lose the ability to change the designation if desired.

5.B. Absolute assignment

When transferring ownership of a policy to Charity, in order to remove the policy from Donor’s taxable estate and receive an income tax charitable deduction for the value of the policy, Donor must make an absolute assignment of the policy to Charity and cannot retain any incidents of ownership over the policy after the transfer. The value of the gift for income tax deduction purposes also must be considered, and it may be necessary to obtain a valuation of the policy from the insurance company to verify the deduction.

5.C. No loans

Donor should generally not transfer a policy with an outstanding loan. This could result in the loss of the income tax deduction for the gift and may also trigger bargain-sale rules resulting in a taxable gain and/or ordinary income to Donor.

5.D. Consult your own advisor

All Iowans are unique and face unique legal and tax challenges. Consult your own professional advisor for advice.

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