Charitable Gifts of Life Insurance

HK Financial Services

The Situation

Many wealthy individuals have a history of giving to their favorite charities. They may want to make sure that these gifts continue should they die prematurely.

Life insurance might be a way for these donors to complete their expected lifetime gifts should they die before life expectancy. The three main ways of making a charitable gift with life insurance are:

- Naming the charity as owner and beneficiary of the life insurance policy;
- Naming the donor as owner and the charity as beneficiary; or
- The donor transfers an existing policy to charity.

Any tax benefits to the donor will vary depending on how the gift to the charity is structured.

Donor Gifts Premiums for Charity to Purchase Policy

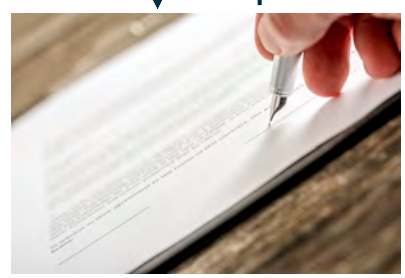
Donor/Insured

1
Gifts of Cash

Charity/Owner/Beneficiary

2
Premiums

3
Death Benefit



Life Insurance Policy

If the donor wants to receive an income tax deduction for his or her gift of premiums, the charity must be the owner and beneficiary of a life insurance policy on the donor.[2] If a charity is the owner and beneficiary of the policy, the financial underwriting may limit the amount of insurance that can be purchased. An established history of giving to that charity may be necessary to justify the amount of life insurance purchased.

The donor may gift cash directly to the charity so that the charity may pay the life insurance premiums directly to the insurance company. In either case, the donor has made a deductible gift to charity or the donor may pay the premium directly to the insurance company.[3] If the donor does not have sufficient income to fully utilize the deduction, any unused portion may be carried forward for five additional years. There is some question as to whether a payment made directly to the insurance company would be considered a gift "to" or "for the use of" charity. If the gift is considered "for the use of" charity, the donor's deduction to the public charity would be limited to 30% of the donor's adjusted growth income (AGI), rather than the 50% AGI limit for cash gifts to public charities. The conservative approach is for the donor to make cash gifts to the charity and have the charity pay the premiums to the insurance company.

1. **Gifts of Cash:** Donor gifts cash to charity every year. Donor receives an income tax deduction.
2. **Premium:** Chartiy uses the gifts of cash to pay for premium on a life insurance policy on the donor. The charity is the owner and beneficary of the life insurance policy.
3. **Death Benefit:** Upon the death of donor/insured, the charity receives the life insurance death benefit proceeds income tax free.[4]

Donor as Owner and Charity as Beneficiary

Donor / Insured

1
Owner / Payor

2
Access

Life Insurance Policy

3
Death Benefit

Charity

If the donor wished to retain control over the life insurance policy, the donor may own the policy and name a charity as a beneficiary of the life insurance policy on his or her life. This strategy does not provide the donor with a charitable income tax deduction.

Upon the donor's death, the life insurance policy will be includible in the donor's estate for estate tax purposes. However, any portion of the death benefits paid to the charity at the donor's death should qualify for a dollar for dollar estate tax deduction. Any portion of the death benefit going to a non-charity (such as heirs) may be subject to estate taxes.[5] This technique may be an appropriate option for a donor who wishes to own the life insurance policy in order to access the policy's cash surrender value for personal needs, but does not necessarily need the death benefit. The donor will also preserve the flexibility to change the charitable beneficiary at any time.

1. **Owner/Payor:** Donor owns, and pays premium on, a life insurance policy on his or her life. Donor names the charity as a beneficiary. Donor does not receive an income tax deduction for premium payments.
2. **Access:** Donor is able to take withdrawals and loans from the life insurance policy. These withdrawals and loans may be income tax-free if up to basis.[6]
3. **Death Benefit:** Upon the death of donor, the life insurance death benefit proceeds are distributed to the beneficiaries of the policy (i.e. the charity, on a tax-free basis). The death benefit proceeds are includible in the donor's estate for estate tax purposes.[5] The estate receives a corresponding estate tax deduction for any portion of the death benefit passing to charity.

Donor Transfers Existing Policy to Charity

Donor / Insured

1
Gifts of Policy / Cash

Life Insurance Policy

2
Premiums

3
Death Benefit

Charity

If the donor has an existing life insurance policy, and would like to donate it to a charity and receive an income tax deduction, he or she may transfer ownership of the life insurance policy to a charity. The charitable deduction will be limited to the lesser of the donor's cost basis in the policy or the fair market value (FMV) of the policy.[7]

The donor's cost basis in the policy is generally premiums paid less withdrawals. The FMV of the policy depends on the nature of the policy. If the policy is a single premium or paid up policy, then the value of the life insurance policy is the amount the company would charge for a single premium contract of the same amount on the life of the insured as of the date of the gift.

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1. **Gifts of Policy and/or Cash:** Donor gifts existing life insurance policy to charity and the charity becomes the owner and beneficiary. Donor receives income tax deduction.
2. **Premiums:** Charity continues to pay any premiums on the life insurance policy by using either the additional gifts from the donor or other funds. If the donor makes annual gifts to the charity for the additional premium, they may be tax-deductible.
3. **Death Benefit:** Upon the death of donor, the charity receives the life insurance death benefit proceeds.

[1] As with all uses of life insurance, the amount of life insurance coverage asked for in conjunction with this concept may be limited by the insurer's financial underwriting guidelines. Financial underwriting is an assessment of whether the proposed death benefit is a reasonable replacement for the financial loss caused by the death of the insured.

[2] In order for a life insurance policy to be considered valid, it must meet insurable interest rules in the state in which it is issued. Most states have enacted laws giving a charitable organization an insurable interest in a donor. Before creating a charitable plan using life insurance, consult your attorney regarding your state's insurable interest laws. Priv. Let. Rul. 9147040 (Aug. 20, 1991).

[3] The maximum charitable income tax deduction for gifts of cash allowed in one year is either 50% of adjusted gross income (AGI) to public charities or 30% of AGI for gifts to private charities. IRC Sec. 170(b)(1)(B).

[4] IRC Secs. 170(b)(1)(B), 170(b)(1)(D)(ii), & 170(d).

[5] According to the American Taxpayer Relief Act of 2012, the federal estate, gift and generation skipping transfer (GST) tax exemption amount are all $5,000,000 (indexed for inflation effective for tax years after 2011); the maximum estate, gift and GST tax rates are 40%.

[6] Tax-free income assumes, among other things: (1) withdrawals do not exceed tax basis (generally, premiums paid less prior withdrawals); (2) policy remains in force until death; (3) withdrawals taken during the first 15 policy years do not occur at the time of, or during the two years prior to, any reduction in benefits; and (4) the policy does not become a modified endowment contract. See IRC Secs. 72, 7702(f)(7)(B) and 7702A. Any policy withdrawals, loans and loan interest will reduce policy values and may reduce benefits.

[7] The maximum charitable income tax deduction for gifts of life insurance allowed in one year is either 30% of adjusted gross income (AGI) to public charities or 20% of AGI to private charities. IRC Sec. 170(b)(1)(A); IRC Sec. 170(b)(1)(B).

[8] Treas. Reg. Sec. 25.2512-6(a), Example 4.

boyum barenscheer
CPAs AND BUSINESS ADVISORS

3050 Metro Drive, Suite 200
Minneapolis, MN 55425
952.854.4244 | myboyum.com

HK FINANCIAL SERVICES
3390 Asbury Rd. | Dubuque, IA 52002
563.588.5519 | 800.791.8994
hkfs.com

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