

Charitable Gifts of Life Insurance

Why Life Insurance?

Life insurance can be a particularly versatile and valuable asset to give to charity. A gift of life insurance can allow a donor to make a more substantial contribution than would otherwise be possible. In addition, a charity owning a life insurance policy has the option of accessing the policy cash value with loans or withdrawals, or holding the policy for the death benefit.

Leverage

The greatest advantage of a gift of life insurance is that a donor can make a substantially larger gift to charity by using life insurance than by giving any other asset. Relatively modest annual premiums mature in a substantial death benefit at the donor's death. This is further enhanced by the income tax charitable deduction the donor receives. The donor's gift essentially costs less. For example, for a donor in a 30% tax bracket, a gift of \$2,500 really costs \$1,750 after factoring in the income tax charitable deduction.

Gift of an Existing Policy

The gift of an existing policy is relatively "painless" to donor in several respects. The transfer is simple; all that is required to complete the transfer is a change of ownership form. Absent a loan on the policy, donor does not recognize income no matter how large the gain. In addition, because a policy is not an asset generally used by donor for current income, it is not often perceived as a "loss" of an asset.

Benefit to Charity

A life insurance policy requires less administration by the charity than many other assets, like real estate or business interests. In addition, the charity can easily take advantage of cash values in the policy before the donor's death by using loans or withdrawals. Both the cash value buildup and the death are generally tax-free to the charity.

Death Benefit

The death benefit, whether from a policy owned by the charity or with the charity as beneficiary, is received by the charity without reduction for estate or income taxes and is not subject to the delays and expenses of probate. The death benefit is less likely to be contested by the donor's beneficiaries than other assets.

CHARITABLE GIFTS OF LIFE INSURANCE

Name Charity as Beneficiary of Policy

- No income tax charitable deduction.
- At death, proceeds may be included in estate; estate receives an offsetting estate tax charitable deduction.

Name Charity as Irrevocable Beneficiary of Policy

- No income tax charitable deduction.
- At death, proceeds may be included in estate; estate receives an offsetting estate tax charitable deduction.

Transfer Policy to Charity

- Income tax charitable deduction.
- Policy not included in insured's estate if gift is more than three years before death.
- Change of ownership and beneficiary designation forms should be completed showing charity as owner and beneficiary.

Transfer Cash Charity to Purchase a New Policy

- Income tax charitable deduction.
- Charity must have insurable interest.
- Policy not included in insured's estate.
- In states where charity has insurable interest in donor, charity should be applicant, owner and beneficiary.
- In states where charity lacks an insurable interest in a donor, donor should be the applicant and charity should be owner and beneficiary.

Pay Premiums on Policy Owned by Charity

- Income tax charitable deduction in year of gift.

INCOME TAX CHARITABLE DEDUCTION

Congress encourages charitable contributions by providing tax deductions for gifts to charity. In order to take advantage of these deductions, a donor must meet certain requirements, and is subject to certain limits.

Amount Deductible

- If giving an existing policy, the amount deductible is the lesser of donor's basis in the policy and the policy value.
- If giving cash, the amount of cash given is the amount deductible.

Adjusted Gross Income (AGI) Limits

- If the gift is to a public charity, deduction is limited to 50% of donor's AGI. Public charities are generally organizations that receive their funding from government and the general public. Some examples of public charities are schools, churches, hospitals, charities for disease prevention or cure and charities that benefit the community.
- If the gift is to a private foundation, deduction is limited to 30% of donor's AGI. Private foundations are generally organizations that receive their funding from a small number of donors, often members of the same family.

Carry Forward

- Deductible amounts not used in the current year because they exceed AGI limits may be carried forward up to five years.

Substantiation Requirements

- The donor must obtain a written acknowledgment of the contribution for charity.
- If the amount of the charitable deduction claimed is \$5,000 or more, donor must also obtain a qualified appraisal.

EXAMPLE

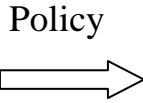
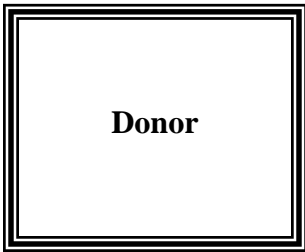
Donor wishes to benefit his/her favorite museum with a gift of life insurance. S/he owns a policy on his/her life with a basis of \$5,000, a cash value of \$35,000 and death benefit of \$10,000. The annual premium for the policy is \$800. The donor wants to receive a current income tax charitable deduction. His/her AGI for this year is \$50,000.

The donor should not merely name the charity as beneficiary. While this gives the charity a death benefit of \$100,000 at Donor's death, it does not provide him/her with a current income tax charitable deduction.

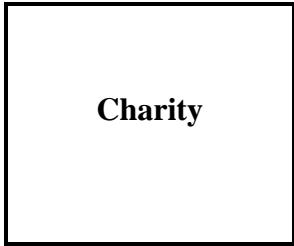
Instead, Donor should give the policy to the charity. The gift entitles him/her to an income tax charitable deduction this year. The amount of the deduction is \$5,000, his/her basis in the policy. Assuming the museum is a public charity, his/her deduction is limited to 50% of his/her AGI - \$25,000. Therefore, the entire \$5,000 is deductible this year. Donor needs to obtain a qualified appraisal or the deduction is denied.

If Donor dies within three years of the gift, the death benefit is included in his/her estate. His/her estate receives an estate tax charitable deduction for the same amount.

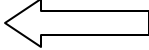
If Donor continues to pay the premium on life insurance policy, either by sending the payment directly to the insurance company or by giving the charity cash, s/he receives an income tax charitable deduction for \$800 each year. In order to claim this deduction, however, Donor needs a written acknowledgment from the museum each year.



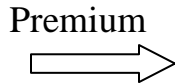
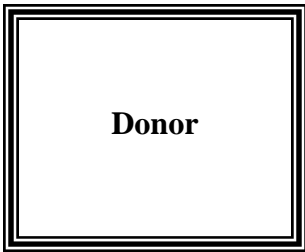
\$35,000 Cash Value
\$5,000 Basis



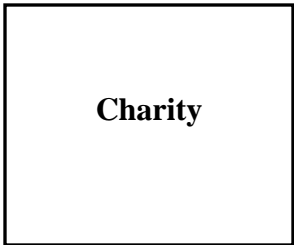
Income Tax Deduction



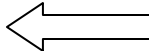
\$5,000



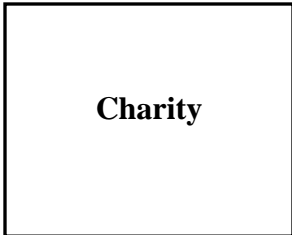
\$800



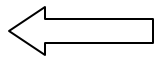
Income Tax Deduction



\$800



Death Benefit



\$100,000

GIFT OF POLICY WITH LOAN

Does it Make Sense?

If a policy with a loan is transferred to charity, donor is relieved from paying off the loan. This is viewed as an amount received, which may trigger income. The bargain sale (or part-gift part-sale) rules allocate the donor's basis in the policy in part to the charitable gift, and in part to the sale. This means that the amount reported by donor as income may exceed donor's charitable deduction.

How is Basis Allocated?

Basis is allocated in the same proportion the loan has to the total policy value, as follows:

$$\text{Basis allocated to sale} = (\text{loan amount}/\text{total value}) \times \text{basis}$$

$$\text{Basis allocated to charitable gift} = (\text{total value} - \text{loan}/\text{total value}) \times \text{basis}$$

Donor can subtract the sale basis from any amount received on the transfer. The basis allocated to the charitable gift is the amount the donor can claim as an income tax charitable deduction.

Example:

Donor contributes a policy with a \$50,000 gross cash value, a \$30,000 basis and a \$40,000 loan. Basis is allocated as follows:

$$\text{Basis allocated to sale} = (40,000/50,000) \times 30,000 = \$24,000$$

$$\text{Basis allocated to charitable gift} = (10,000/50,000) \times 30,000 = \$6,000$$

Donor is relieved from paying back \$40,000 and can allocate \$24,000 of basis, leaving \$16,000 of income. Donor's charitable gift is limited to the charitable gift basis, which produces an income tax charitable deduction of \$6,000.