

Charitable giving through life insurance: Making that special gift

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Many of us have charitable objectives. We would like to repay society for the blessings we've received and, at the same time, fulfill a desire to "give back" to those who have given us so much. But many of us may feel somewhat frustrated — having the desire to make substantial gifts and yet feeling that our resources will not permit it. The common perception is that any meaningful charitable giving must be left to the wealthy. This is not necessarily so.

There is a method of giving that provides the opportunity to do far more for a charitable organization than you might think possible, even if your financial resources are limited. Life insurance is traditional fare on the menu of planned gifts. Making a gift of a life insurance policy to one's favorite charity appeals to a variety of donors because it is a flexible, cost-effective, and in many cases tax-advantaged way to make a major gift that will benefit the nonprofit institution after the donor dies. Life insurance can also be used as an asset-replacement strategy. Under this strategy, a donor makes a gift of an asset (such as real estate or appreciated securities) to the nonprofit and replaces the value of that asset to benefit his/her heirs with a life insurance policy owned in a way that eliminates estate taxes on the benefit that inures to the donor's heirs.

“Simply put,” states Attorney Michael Dobronos “this is giving from the grave after you have expired. Charitable giving through life insurance, properly structured, can pay dividends for many years.”

Gifts of life insurance: The basics

There are two basic ways to make a gift of life insurance: an irrevocable gift of a new or existing policy where the donor gives up all incidents of ownership, or by naming the nonprofit organization as the outright or contingent beneficiary of a policy. Each approach has advantages and disadvantages.

Irrevocable gift of an existing policy. If a donor owns excess life insurance (perhaps purchased for a reason that no longer exists), he, she or it (if a corporation) might consider making an irrevocable gift of the policy to a charity. If complete ownership is transferred to the nonprofit and the charity is named as the beneficiary, the gift will generate a charitable income tax deduction.

If the policy is fully paid for (i.e., no premiums remain to be paid), the deduction is generally equal to the policy's replacement value or the donor's basis, if the replacement value exceeds the basis. If premiums remain unpaid on the policy, the deduction can be calculated based on the policy's interpolated terminal reserve value – a value that might be slightly in excess of its cash surrender value. If the donor continues to pay the premiums on the policy (either directly to the insurance company or as a gift to the nonprofit organization that pays the premium), each such payment is tax deductible as a charitable gift. If the cash surrender value – or, in the case of a paid-up policy, its replacement value – exceeds \$5,000, the donor must seek an independent appraisal and file a Form 8283 with his/her tax return.

Irrevocable gift of a new policy. A donor may take out a new policy and irrevocably name the nonprofit organization as the owner and the beneficiary of the insurance contract. This can be an attractive strategy for a younger donor, because the premium cost is usually low compared with the ultimate death benefit that will accrue to the charity upon the donor's death. Whether the donor makes one single premium payment for the policy or pays premiums annually, each payment produces a charitable income tax deduction.

To maximize the tax advantage of this gift, the donor should consider making annual gifts of appreciated securities to the nonprofit organization, which will then make the premium payment. This will produce a charitable deduction based on the fair market value of the gift of the securities on the date the stock is transferred to the charity, and all capital gains tax that would have been paid had the securities been sold, will be avoided.

Pros and cons of an irrevocable gift of life insurance.

When making an irrevocable gift of a policy to a nonprofit, the primary benefit to the donor is the charitable deduction that results for the value of the policy on the date of the gift and for each subsequent insurance premium that is paid. The downside is that the gift is irrevocable – the donor can't take it back. Nevertheless, if there are premiums to be paid, the donor always has the option to discontinue paying those premiums. However, the nonprofit, as owner of the policy, has the right to (1) continue making the payments, (2) take advantage of a cash surrender option (if there is any cash value in the policy), or (as discussed later) (3) seek a life settlement solution.

Naming the charity as a primary or contingent beneficiary. If the donor wants to retain maximum flexibility, the charity can be named as either the primary or contingent beneficiary of the policy. This will not produce an income tax charitable deduction for the payment of future premiums on the policy, but it does afford the donor a full estate tax charitable deduction when the donor dies. The concept of naming one's favorite charity as a contingent beneficiary of a policy could be a good strategy for a childless married individual who wants to assure maximum protection for his or her spouse while both spouses are alive, yet wants to provide a benefit to the charity if the primary beneficiary predeceases the insured or both perish in a common disaster.

To begin the process, the Step 1 is to decide how much you would like to give to a favorite cause on an annual basis. Step 2; consult with a qualified life insurance agent to determine what kind of death benefit such a gift - as a premium payment to a life insurance policy - might cost to purchase. Step 3; contact a representative of your favorite cause who directs the endowment programs for that cause, and discuss this proposed strategy. Carefully consider all aspects of gifting money in this manner. Step 4 involves filling out an application for a permanent life insurance policy on your life, naming you as the insured, and the charity or favorite cause as the owner and beneficiary of the policy. It is not necessary to set up a trust fund with its associated expenses, unless you want to do so. Step 5; upon successfully completing the underwriting process, have the insurance agent set up a meeting with you and the charity's representative to go over the issued policy and, if the policy is acceptable to all parties, make a donation to the charity in the amount of the policy's premium payment. With Step 6 you should obtain a complete photocopy of the insurance policy for your records. Step 7; obtain a receipt for your donation documenting your tax-deductible payment to a charitable cause for that tax year. Step 8 is to continue to make donations for as long as premiums are necessary to keep the policy in force, taking a tax deduction each year for the donation (as far as is allowable under the tax code current at that time). Step 9 is when you die, the charity or cause will receive an income-tax-free payment by virtue of the policy's death benefit, which is likely to be many times greater than the sum of all of your donations for premium payments.

Gifts of life insurance do not require constant attention as other types of investments may require. There are a variety of ways to set-up a charitable gift using life insurance:

- ***You may give a gift that becomes self-completing.*** Life insurance can provide for a self-completing gift in the event of your death or disability.

- ***You may give a bequest at death.*** The proceeds of the policy will be paid to their charity free of any federal estate tax. This will be true whether you own the policy or the charity owns the policy.
- ***You may continue to own your policies, and name your favorite organizations as beneficiaries.*** If you are concerned that your family's circumstances may change in the future, you may name the charity as "revocable" or "contingent" beneficiary and still retain flexibility and control. The policy's proceeds will be passed free of both gift and estate taxes.
- ***You may give an existing policy.*** You may have several insurance policies, each purchased at different times in your life to satisfy a specific need at that time. Some of those needs may no longer exist (e.g., home mortgage or children's education). Your gift of that policy to charity allows you to take an income tax deduction for the amount of the policy's fair market value (approximately the policy's cash value) in the year you transfer the policy. Any future premiums paid are also income tax deductible.
- ***You may give policy dividends.*** Life insurance policy dividends received in cash can be donated to charity. This is an easy, economical way to make charitable gifts and generate income tax savings.

Charitable giving using life insurance is both beneficial and a favored means of making charitable contributions for a number of reasons:

- ***The death benefit going to your favorite charity is guaranteed as long as premiums are paid.*** This means that the charity will receive an amount which is fixed in value.
- ***Life insurance provides an amplified gift that can be purchased on the installment plan.*** Through a relatively small annual cost (premium), a large benefit can be provided for your charity. A large gift can be made without impairing or diluting the control of your family business interest or other investments. Assets earmarked for your family can thus be kept intact.
- ***Life insurance is a self-completing gift.*** If you become disabled, the policy can remain in full force through the waiver of premium rider. Even if death occurs after only one premium payment, the charity is assured of its full gift. Additionally, the death proceeds can be received by your designated charity free of federal income and estate taxes, probate and administrative costs and delays, brokerage fees or other transfer costs.
- ***Because of the contractual nature of a life insurance contract, a large gift to charity is not subject to attack by disgruntled heirs.*** Life insurance proceeds do not run afoul of the so-called mortmain statutes that prohibit or limit gifts made within a short time prior to death.
- ***A substantial gift may be made with no attending publicity.*** Since the life insurance proceeds paid to charity can be arranged so that they will not be part of your probate estate, the proceeds can be paid confidentially. Of course, publicity may be given if desired.

If you have ever wondered how you might "give something back," or felt drawn to support a particular charity, one of the most affordable and beneficial ways, is through the use of life insurance.

Life insurance: A wealth-replacement strategy

As part of a comprehensive philanthropic, estate and financial plan, it might be more advantageous to donate a highly appreciated asset to a charitable organization, because the donor will usually be able to take a charitable deduction for the fair market or appraised value of the asset. Once the asset is in the hands of the charity, there will be no capital gains tax on the subsequent sale. The donor, in effect, gets a double benefit – a substantial deduction and elimination of the capital gains tax. The charity receives its benefit when it might be most beneficial rather than having to wait until the donor dies. However, the loser in such an arrangement may be the donor's heirs because the asset will no longer be available for inheritance. This is where life insurance can play an important role.

The donor can purchase a life insurance policy and irrevocably either (1) name an heir or heirs as the owners or (2) create a special trust that will become the owner of the life insurance contract. The insured might use the tax savings from the charitable gift to purchase a single premium policy or choose to pay premiums annually. In either case, if the policy is irrevocably owned by either a trust or some third party outside the policy holder's estate, the eventual death benefit will pass tax-free to the named beneficiaries. When the insured makes the premium payments on a policy that is owned by another, whether or not it is in trust, there may be gift tax consequences. Therefore, as with any estate, tax, or financial planning matter, the insured should seek the advice and counsel of his or her tax planning professional.

This strategy has been popular when coupled with a charitable remainder trust (CRT) that pays the donor and spouse an income for life; at the death of the last income beneficiary, the remainder goes to charity. Using the same concept, the donor can (1) make a gift of a highly appreciated asset to the CRT, (2) generate a charitable income tax deduction for the present value of the gift that will ultimately go to the charity, (3) avoid the capital gains tax on the asset when it is sold inside the trust, and (4) secure a new source of income for life. The wealth-replacement strategy can be overlaid to provide for heirs who would have received the asset but for the charitable plan.

Life settlement: How to get the most out of life

Life insurance has traditionally been used as a deferred gift for the benefit of charity or as a wealth-replacement strategy for other assets that may have been gifted to a charity. But what if the charity is in the midst of a capital or endowment campaign and needs current dollars? What if it owns life insurance contracts on some of its donors and would like to *turn a future asset into a current asset*? Or, what if a donor does not choose to make a gift of securities or other assets he/she might own, but has excess life insurance that was purchased for a need that no longer exists? Could that life insurance policy be used to generate a substantial *current* benefit for charity and, perhaps, a deferred benefit as well?

The concept of a life settlement is not new. Simply put, it is the sale of an "in-force" life insurance policy by the policy's legal owner to a third party when the insured is not deemed to have a terminal illness. In most cases, to qualify for a life settlement offer, the named insured must be at least 65 years old. Other criteria, such as age above 65, health condition, and premium structure, are factors that will determine the amount that a company will offer. Because this is not a surrender of the policy for its cash value to the insurance company that issued the policy, it does not matter whether there is any cash value at all in the contract. If an offer is made on a particular policy that has a cash surrender value, the offer usually far exceeds the cash accrued in the policy.

Practical application of the life settlement solution

- A nonprofit institution that already owns insurance on the life of a qualifying donor can discuss with that donor the benefit of the institution's seeking a life settlement solution to help with current cash needs.
- A qualifying donor (age 65+) who is being solicited by a nonprofit organization for a capital or endowment campaign gift can review his or her insurance portfolio with a view toward seeking a life settlement and making a gift of the cash proceeds, or giving the policy to the nonprofit organization, which will seek the life settlement on behalf of the donor. Since making a gift of the policy or of the cash proceeds after the policy is sold will produce different tax consequences for the donor, advice from a tax practitioner should always be sought in advance.
- The following examples suggest life settlement strategies that maximize the gift-giving potential of life insurance and assure that the donor and the nonprofit institution get the most out of life.

Example 1. A small museum is the owner and beneficiary of a \$500,000 life insurance policy given by a member. The donor made the gift of the new whole life policy when he was age 65. Each year, over and above his gift to the annual fund, the donor makes a gift to the museum to cover the cost of the premium on the policy. The donor is now 75.

The museum is in a financial crunch and needs to generate cash to cover the costs of capital improvements to the campus. However, it is also looking to its long-term future and to growing its endowment for which the donor made the gift of the life insurance policy. The Business Development Chair meets with the donor and suggests a way to solve the immediate needs of the museum while being mindful of its longer-term needs.

- Let the museum seek a life settlement (a sale) of the policy and use the proceeds to meet current cash needs. Depending on the health of the insured at the time the offer is made and several other determining factors, an offer might be at least three times the cash surrender value of the policy.

- Because the donor has been making annual gifts of \$15,000 each year to cover the cost of the premiums, ask the donor to consider continuing to make the same payments on a new policy to replace the one that the museum sold. Of course, the amount of the death benefit and whether the donor is even insurable will depend on his health at the time of the new application. Although the new death benefit will most likely be less than the original because the donor is older, it will help offset the difference between what the museum realized "up front" on the sale of the policy and what it would have received if the policy had not been sold.

Example 2. The same museum offers a charitable gift annuity program to encourage its more senior members, who might need additional current income, to make a planned gift that meets that objective while helping the institution build its endowment fund. Traditionally, donors have made gifts of cash, appreciated securities, and real estate to fund a charitable gift annuity.

In the course of a meeting with a 75-year-old prospective donor, the museum's planned Business Development Chair learns that the donor wants to increase his annual income and is interested in a charitable gift annuity. Although the member has already divested almost all his appreciated securities, he does own a life insurance policy that is no longer needed and, in fact, the insured does not want to continue paying the premiums on the policy. How could a life settlement help the museum secure a much needed charitable gift and meet the donor's need for more income?

- The donor can use life insurance as a gift to fund a charitable gift annuity.
- Depending on whether the donor seeks the life settlement and makes a gift of the proceeds, or makes a gift of the policy and lets the museum seek the life settlement, there will be different income tax consequences. In either event, the donor is eligible for a charitable income tax deduction in the year the gift is made.
- Although the amount of the life settlement offer will differ, depending on the age and health of the donor as well as other factors, the amount realized will in most cases be two to three times the cash surrender value of the policy.
- The general benefits to the donor are: (1) turning an unproductive asset into an asset that produces a new source of predictable, guaranteed, high-yield income; (2) saving money by not having to pay an annual premium on the policy; (3) generating a charitable income tax deduction; and (4) making an important charitable contribution to the museum.

Conclusion

If you would like to make a truly special gift - one that creates a living legacy in your name - **life insurance** may be the answer. It's a low-cost way to endow a favorite institution or association and can go a long way to minimizing the final tax payable upon your death.

"I think charitable giving through life insurance can be a very effective tax advantage for estate planning purposes. The best charitable giving life insurance plans are structured through a family lawyer with the advice and consent of the agent and charity representative." says Dobronos.

This method of planned giving also allows you to leave a sizable bequest to your favorite charity while ensuring minimal impact on the beneficiaries of your estate.

Charitable giving through life insurance is a relatively straightforward estate planning solution. However, it is important to remember that in order for it to be effective; you must ensure that the policy in question is a permanent one. In other words, it must remain in effect until you die.

Charitable giving through life insurance is becoming more and more popular. It's financially effective because a substantial asset can be created with a comparatively small investment. Also, there are none of the administrative expenses or potential estate disputes associated with bequests made in a will.

"Charitable giving through life insurance is an excellent legacy for those who have not been blessed with children and even for those who have been blessed with children," Michael Dobronos goes on to say that "Charitable giving is a special way to be remembered long after you have left this earth."

If you have responsibilities as a fund raiser for a charitable organization, you may also want to investigate how life insurance might play a part in your planned gifting program.

Attorney Dobronos believes that "Charitable giving is a special way to be remembered long after you have left this earth. While you may be gone, your charity will fondly remember your sincere commitment in continuing contributions."

The use of life insurance as a charitable gift doesn't have to be just another bland item on the menu of charitable gift planning strategies. There are many ways to "spice it up" to suit the changing needs of the nonprofit organization and a donor's planning palate. Most donors and nonprofit organizations think of life insurance only as an asset that produces a future benefit for the nonprofit organization. However, by using the wealth-replacement strategy and/or the life settlement solution to meet the needs of the donor's family and the nonprofit, charitably inclined individuals can truly get the most out of life.

The above article is meant to give a general overview of insurance policies; exact coverage and terminology could vary by insurance company. **Please refer to your policy for exact coverage details and terminology.**

About the Author

Nicholas Schidowka began his work in the insurance and financial services industry in 1997. In 2001 he obtained Ohio licenses in Property and Casualty insurance and Life and Health insurance. Since then, he has worked hard to provide various insurance services to his customers including auto, business, health, home, and life. His professional and courteous

approach to the insurance field has cultivated a diverse and loyal clientele in the Cleveland (Parma), Ohio area.

In 2007, Insurance Cleveland Agency LLC was formed. As an independent agency, Insurance Cleveland Agency has access to several different insurance carriers including Encompass (owned by Allstate), The Hartford, Ohio Casualty, Progressive Drive, Safeco, Travelers, Victoria (owned by Nationwide), Dairyland/Viking etc.

Insurance Cleveland Agency is pleased to announce the addition of Ivan Voytovych to their team! Mr. Voytovych is a highly qualified and valuable addition to the ICA team and helps the agency cater to the company's English, Ukrainian and Russian speaking customers.

Insurance Cleveland Agency is conveniently located off of Pearl Road and Highway 71 in the Islander Office complex. Office hours are Monday – Friday 9:00 am to 12:30 pm and 1:30 pm to 5:00 pm. Please call ahead for an appointment. We look forward to hearing from you in the near future!

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