Life Insurance as a Strategy to Enhance Charitable Giving

Life insurance can be an excellent tool for charitable giving. Not only does life insurance allow you to make a substantial gift to charity at relatively little cost to you, but you may also benefit from tax rules that apply to gifts of life insurance.

Why use life insurance for charitable giving?

Life insurance allows you to make a much larger gift to charity than you might otherwise be able to afford. Although the cost to you (your premiums) is relatively small, the amount the charity will receive (the death benefit) can be quite substantial. As long as you continue to pay the premiums on the life insurance policy, the charity is assured to receive the proceeds of the policy when you die. (Guarantees are subject to the claims-paying ability of the issuing insurance company.) Since life insurance proceeds paid to a charity are not subject to income and estate taxes, probate costs, and other expenses, the charity can count on receiving 100 percent of your gift.

Giving life insurance to charity also has certain income tax benefits. Depending on how you structure your gift, you may be able to take an income tax deduction equal to your basis in the policy or its fair market value (FMV), and you may be able to deduct the premiums you pay on your annual income tax return. When an insurance contract is transferred to a charity, the donor's income tax charitable deduction is based on the lesser of FMV or adjusted cost basis.

What are the disadvantages of using life insurance for charitable giving?

In general, you must be able to qualify both medically and financially to obtain any life insurance. You should first secure the life insurance that you want to leave to your heirs. Then, if you choose to use all or a portion of the remaining insurance you may obtain on your life, you can donate the remaining life insurance to your favorite charity.

Methods to give life insurance to charity

The simplest way to use life insurance to give to a charity is to name a charity to receive part of all of the benefits of your life insurance policy. You, as owner of the policy, simply designate the charity as beneficiary. Designating the charity as beneficiary may allow you to make a larger gift than you could otherwise afford. If the policy is a form of cash value life insurance, you still have access to the cash value of the policy during your lifetime. However, this type of charitable gift does not provide many of the income tax benefits of charitable giving, because you retain control of the policy during your life. When you die, the death benefit amount is included in your gross estate because you own the policy, although the amount of the proceeds payable to the charity can be deducted from your gross estate. Since many life insurance policies issued today have accelerated death benefit provisions in the event of chronic illness or long-term care expenses, many owners choose to continue to own the life insurance with payment of all or some of the remaining death benefit payable at the insured's death to charity.

Another alternative is to donate an existing life insurance policy to charity. To do this, you must assign all rights in the policy to the charity. You must also deliver the policy itself to the charity. By doing this, you give up all control of the life insurance policy forever. This strategy provides the full tax advantages of charitable giving because the transfer of ownership is irrevocable. You may be able to take an income tax deduction equal to the lesser of your adjusted cost basis of the policy or the policy fair market value. The policy is not included in your estate when you die, unless you die within three years of the transfer. In this event, your estate would get an offsetting charitable deduction. Any future premiums paid by you as a donation to the charity may also be deductible. Consult your tax advisor whether you can qualify for charitable deductions. Keep in mind that any donated policy should not have any policy loan as this will create adverse income tax consequences.

Some individuals who have group term life insurance could name a charity the revocable beneficiary of group-term life insurance on his or her life, either in full or in an amount in excess of $50,000. The advantage of this technique is that it eliminates the need for the client to report Table I income tax cost of the term insurance coverage in excess of $50,000, as long as the charity remains the beneficiary. The charity must be the beneficiary for the entire tax year to avoid the Table I income inclusion for that year.

A method that many people use to donate to a charity is simply for the charity to insure you. To use this strategy, you would allow the charity to purchase an insurance policy on your life. You would make annual tax-deductible gifts to the charity in an amount equal to the premium, and the charity would pay the premium to the insurance company.

Most charities have gift acceptance policies which detail what types and amounts of life insurance each charity may be willing to accept. Check with the individual charity to determine what guidelines are in place.

One final method is to use a life insurance policy in conjunction with another gift to a charity. This could be a complete gift, such as a gift of property, or a partial gift with a retained interest such as a charitable gift annuity. Often, there is an intervening trust such as is the case with a charitable remainder trust. The purpose of the life insurance is to fully or partially replace the value of the donated property to the heirs. In these situations, a third-party owner such as an irrevocable life insurance trust is often used. Any income tax savings because of the deductible property donation to charity may be used to aid in paying the life insurance premiums.

Conclusion

Life insurance can be a powerful tool in enhancing your charitable giving. Contact your favorite charity whether they have guidelines on how life insurance can be used, and consult with your tax advisor about any potential tax benefits of using life insurance as part of your charitable giving strategies. A gift of life insurance permits the donor to make a substantial gift for a relatively modest annual outlay.

Summary of Benefits with Charity as Owner of Life Insurance Policy

Advantages to Charity	Advantages to Donor
More donors can make major gifts	Lower cost to your estate and heirs
Charity controls life insurance policy	Amplifies gift
A growing asset, cash, provided during lifetime	Experience the rewards of giving during lifetime
Perpetuates annual gift of a donor	Larger gifts without impairing other assets
Gift is free of probate, taxes, and debts of donor	Premiums may be flexible in amount and/or limited in duration
	Gifts may be made with no publicity and cannot be contested
	May create income tax deduction, plus estate tax savings by removing asset(s) from estate