

## Donating Insurance: A Primer on Premium Financing ©

Eileen Gunn , Written by HNW for Community Foundations of America.

Donating life insurance to a favored charity, a popular way to give, can be a win all around. But now, an increasing number of well-heeled donors are using a new strategy known as premium financing to give substantial gifts using life insurance.

With premium financing, donors agree to be covered by an insurance policy that names a designated nonprofit organization as the beneficiary, and finance the premiums with a loan. When the donor passes away, the death benefit covers the repayment of principle and perhaps interest as well, with the remainder of the policy payout going to the designated organization.

By using investments as collateral for the loan instead of selling them outright, donors can support their favorite causes without sacrificing future earnings potential. Its a way to use your wealth to benefit a charity without having to liquidate assets, says Kevin Warner, director of premium finance sales at ING.

### Substantial Tax Benefits

The intersection of life insurance and philanthropy creates myriad possibilities: donors can gift paid-up policies or policies on which they are currently paying premiums. They can also purchase a new policy on behalf of a nonprofit organization, assign dividends, or name a designated organization as the beneficiary on existing policies. Donors can receive substantial tax benefits from donating policies, though deductions will change depending on the way the policy is donated:

If you

Give a paid-up policy...You may deduct -Approximate cash surrender value

Give a policy on which you are paying premiums...You may deduct -Approximate cash surrender value and future premiums paid

Purchase a new policy for charity...You may deduct -Premiums (if charity is named owner)

Assign dividends to charity...You may deduct -Value of dividends

Buy a policy to guarantee a pledge to charity...You may deduct -Premiums (if charity is name owner)

Name a charity as first, second, or final beneficiary on policies you own...You may deduct -Premiums are not deductible unless the first beneficiary is irrevocable owner of policy

*Source: AARP*

These days, though, with interest rates still near record lows, premium financing is an increasingly attractive way for affluent donors to give substantial gifts.

### Leveraging Illiquid Assets

Premium financing is most appropriate for the high net worth donor. "They are people who have already taken care of their families, retirement, and transfer-of-wealth issues, and want to reach further into the

philanthropic world than they have already," says Warner. In addition, says Warner, premium financing may be a particularly savvy giving option for donors whose assets are tied up in real estate or other hard assets.

Youth is usually an advantage when buying life insurance. But, in the case of these premium-financed policies, target customers are in their 60s or 70s. That's because lenders aren't willing to wait 30 years or more to recoup their loans.

"Lenders have told me that ten years is the limit," says Domingo Such, who has recently arranged several premium financings as a partner at law firm McDermott Will & Emory in Chicago. After a decade, Such adds, lenders may ask for the unpaid interest that's been generated so far, or even repayment of the entire loan.

There's also a limit to how much insurance an individual can and should buy. The rule of thumb is that your assets should be worth twice as much as the combined pay outs of all the policies you have, says ING's Warner. Experts say donors should take stock of their family's life insurance needs before taking out a policy on behalf of a charity. If you decide afterward you want life insurance, say to cover estate taxes, you might be out of luck, cautions McDermott Will & Emory's Such.

### **Choices and Considerations**

Donors must carefully weigh their options when financing premiums. While it is possible to defer interest on the loan until the policy is paid out, making the transaction virtually cost-free to the donor, there may be less money available for the charity when the policy pays out. As an alternative, a donor can make tax-deductible contributions to the nonprofit organization, which can in turn use the funds to pay interest on the loan. In this scenario, only the principle—for example, anywhere from \$3 million to \$10 million for policies worth \$5 million to \$15 million—will have to be paid by the recipient organization when the donor passes away.

Since rates on loans are usually variable rather than fixed, it's important to understand how interest rate moves will affect the gift. In particular, donors should work with their advisors to determine how much money will actually be left over for the charity as rates move up.

An additional consideration: Donors who let the nonprofit own the policy instead of taking it out themselves give up a measure of control over their gift. That's why attorney Such recently urged a client to make his estate the beneficiary of a premium-financed policy, rather than the charity itself. In that way, Such's client, who intends to donate the proceeds to the charity, can maintain control over the gift.

Premium financing is a sophisticated gifting strategy. Handled in the right way for the right kind of donor, it's a powerful way to leverage your assets—and your charitable spirit.

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