Leveraging Charitable Gifts with Life Insurance ©

Donald J. Korn , Community Foundations of America

Charitable gifts of life insurance can bring many benefits to donors and the causes they support, but regulations can complicate these gifts. Advisors can help donors navigate the complex IRS rules to ensure that gifts substantially benefit the donors favorite charities-and fit efficiently into donors' estate- and tax-planning strategies.

Estate planner Steve Leimberg recently followed his own advice and changed his life insurance policy. "I donated an existing policy to a public charity," he says.

Leimberg, the president of Leimberg Associates, a publishing and software company in Bryn Mawr, Pennsylvania, and author of The Tools and Techniques of Life Insurance Planning, says a direct donation of a policy to charity is one of the most popular and straightforward ways to support a favorite cause. "Individuals can make a significant contribution with a relatively modest cost, using the leverage provided by life insurance," he notes.

Charitable gifts of a life insurance policy can bring substantial benefits to charities and the donors who support them. But IRS rules can make giving these vehicles complex. Advisors can help donors give more effectively by understanding the advantages and drawbacks of using life insurance and determining which solution is right for the client's needs.

There are many benefits to gifting a life insurance policy. Donors can make larger gifts to their favorite causes without a major cash outlay. Charities benefit by receiving a larger gift than they might have otherwise received. Using life insurance in philanthropic strategies can also provide clients with tax savings as well as current recognition at a level commensurate with the size of the future charitable gift. "Most charities will list the client as a donor of the amount of the death benefit, but the client only pays the premiums," says Herb Daroff, director, estate and business planning, Baystate Financial Services, in Boston.

Policy Gifts

When clients wish to donate an existing life insurance policy, cash value policies, such as permanent life insurance, are often a better option over term life policies. Term life insurance is generally used for temporary needs, and there is no accumulation of cash value. "By definition, term life policies run out," says Leimberg. "With a gift to charity permanent life policies work best."

To see how this approach might work, let's assume a client has paid $96,000 in premiums on a $1 million life insurance policy. He no longer needs the insurance, so he gives it to a community foundation, which will receive $1 million at his death. If the client desires, the death benefit can be paid into a donor advised fund in which heirs or family members can remain involved in charitable giving from that fund. The policy can be removed from the clients taxable estate, no gift tax need be paid, and the client can deduct the $96,000 that was previously paid into the policy, subject to the limits on charitable deductions.

But clients should be mindful of where they send checks for premium payments. "After an insurance policy is donated, and if clients write checks for ongoing premium payments directly to the insurance company, their deduction can't exceed 30% of their adjusted gross income (AGI)," notes Lee Slavutin, chairman of Stern Slavutin-2, an insurance and estate planning firm in New York.

Instead, the client should write checks to the charity, which then remits the premiums. "If so," says Slavutin, "contributions will be deductible up to 50% of AGI." Either way, excess charitable contributions can be carried forward for up to five years.

"I suggest rounding up the contribution," adds Leimberg. "If the annual premium is $8,950, for example, the donor should write a check to the charity for $9,000. The result will be a cleaner deduction, with less hassle in case of an audit." Leimberg adds that duplicate premium notices should be requested after a policy donation, so that the client and the charity know when payments are due.

Changing the Beneficiary

Clients who don't want to give away an insurance policy can instead name a charity as the beneficiary. Making the designation revocable permits the client to replace the beneficiary, but rules out a current income tax deduction.

"Clients should never name a charity as irrevocable beneficiary," says Leimberg. "That won't provide a tax deduction, and clients lose flexibility because they cant change their mind. Either the beneficiary designation should be revocable or the client should give the policy to charity, without retaining any incidents of ownership."

If a policy is given to charity, clients should be reminded that noncash gifts require appraisals for deductions over $5,000. "Such a valuation should not be from the client's own insurer or agent," says Slavutin. "Another agent or broker can provide an appraisal."

Alternative Strategies

Another option is to take out a new policy for the benefit of the charity. "In some states," says Slavutin, "a charity may not be permitted to have an 'insurable interest' in an individual donor. In such states, if the charity applies for the policy, the tax benefits will be lost." Clients might be better off applying for the policy personally, then transferring it to charity.

Employees may also have another option. Employers can provide a tax-free group term insurance policy to employees for up to $50,000 per employee; employees who wish to have additional coverage will need to pay income tax on the excess coverage, and it must be paid with after-tax dollars. However, employees can name a charity as a beneficiary of the policy or of the excess coverage. In these cases, no income tax deduction is allowed, but income tax is avoided.

For life insurance to be an effective tool in planned giving, the policy's death benefit should substantially benefit charity. Knowledgeable advisors can help ensure that charities benefit from substantial gifts, while donors receive tax and estate planning when supporting their favorite causes.

Donald J. Korn is a freelance writer based in New York City.