

Charitable uses of life insurance benefits

Life insurance can be used in a variety of ways for charitable gifts. Financial representatives can help clients who are charitably inclined by discussing the advantages of using life insurance to meet charitable objectives and explaining transfer strategies and corresponding tax consequences.

There are many reasons to use life insurance to make a charitable gift:

- **Death benefit.** Assuming policy premiums are paid, the charity's receipt of the death benefit less any loans is ensured.
- **Increased amount transferred to a charity.** Because the amount of the death benefit is normally much larger than the premiums paid, a client can give more to a charity than he or she otherwise thought possible or could afford.
- **Accessible cash values.** If a charity owns a policy, it can access cash values at its discretion.
- **Not subject to probate.** A death benefit is transferred without the delay and cost of probate.
 - Furthermore, the contractual nature of life insurance may dissuade potential contests by disgruntled heirs.
- **Tax benefits.** Structured properly, a life insurance death benefit is not subject to estate tax or income tax.

Policies can be used in many ways to make charitable gifts, including:

Charity-owned

Donating an existing paid-up policy to a charity. The client may receive an income tax deduction equal to the lesser of the policy's cost basis or its fair market value.

Donating an existing policy with additional premiums payable. Again, the client may receive an income tax deduction equal to the lesser of the cost basis or fair market value. In subsequent years,

The client may receive additional deductions by transferring cash to the charity to pay the premiums.

Matching premium payments. The client may receive an income tax deduction for giving cash to a charity to pay part or all of the premium due on a policy owned by a charity. The charity may pay any remaining premium amount from its own funds.

Client-owned

- **Naming a charity as the primary or contingent beneficiary of a policy.** The client receives no immediate income tax deduction and the policy death benefit is included in the client's estate, offset by an estate tax charitable deduction.

- **Donating cash dividends received from a policy to a charity.** The client may receive an income tax deduction each year the dividend is paid to the charity.

Third-party owned

- **Donating property to a charity and using life insurance as a wealth replacement tool.** An income tax deduction may be immediately available for the charitable gift. The tax savings from the deduction are used to purchase a policy to replace the wealth the client's heirs would have received.

Regardless of the way a policy is used to make a charitable gift, several factors should always be considered before completing the gift:

- **Policy with a loan.** A client may trigger taxable income when transferring a policy with a loan to a charity.
- **Insurable interest.** A charity must have an insurable interest on the life of an insured or deductions may be lost. State laws generally provide an insurable interest, but must be reviewed.
- **Gift of an entire interest.** A client must assign the charity all incidents of ownership, rights and benefits of the policy to receive any tax deductions.
- **Charitable gift limitations.** A client's annual charitable deduction depends on the type of property contributed, the type of charity receiving the property and the client's adjusted gross income. Any unused deduction may be carried forward for five years.
- **Qualified charity.** A transfer must be made to a qualified charity to be eligible for tax deductions.
- **Term insurance.** The value of a term insurance policy for deduction purposes is normally its unearned premium. Consequently, this type of policy is not often given to a charity.

Life insurance may be used in a variety of ways to accomplish the charitable objectives of a client; however, an appropriate use of a policy can only be determined after considering a client's charitable objectives, the characteristics of a policy and a client's estate and income tax situation.