

*How You Benefit by*  
G I V I N G  
L I F E I N S U R A N C E

*a donor's guide*

© The Stelter Company

GIFTS OF LIFE INSURANCE  
Learn about the benefits to you and us.

**W**hen you first bought a life insurance policy, you had a purpose in mind—probably to help ensure the financial stability of your family should something happen to you or your spouse. Have your circumstances changed since then?

Life insurance can be a tool with many purposes. For example, it can provide liquidity for paying taxes and other expenses at death. But, believe it or not, some of the most satisfying uses for life insurance policies are connected with charitable giving!

If you have an old life insurance policy you no longer need, you might contribute it to a charitable cause in which you believe. Purchasing a new policy and naming us beneficiary is another possibility. This often makes a significant future gift feasible and affordable, especially for younger donors.

Perhaps you are considering a sizable bequest to us, provided your family's future inheritance is not affected. Life insurance can play a part in meeting this goal, too, by replacing for your heirs the amount donated.

The versatility of life insurance makes revisiting its uses a good idea, and that's what this brochure will help you do.

Indirect Use of Insurance for Wealth Replacement

In recent years, probably the greatest increase in the use of life insurance in philanthropic plans has been to replace for heirs of

an estate a value being given, by one means or another, to a charitable organization.

In its simplest form, a significant outright charitable gift might reduce the projected value of inheritances for family members. However, depending on the age, health and marginal income tax rate of the donor(s), income tax savings from use of the charitable deduction can be enough to purchase life insurance with death benefits equal to the value of the gift.

Example: Joan makes a charitable gift of a building that has appreciated in value since she acquired it long ago. She knows that, among other benefits, this results in greater tax savings for her estate than if she had bequeathed the building to her children. (She might also have sold the building, but then she would have been forced to pay capital gains tax.) She then purchases life insurance for the benefit of her children, an expense that she would have paid anyway in taxes, had it not been for the charitable deduction she received for her gift to us. Instead of receiving a building, her children will receive cash from the insurance policy—and all of this happens outside the probate process.

If your projected estate is taxable, ownership of life insurance by others (which also keeps death benefits out of the probated, taxable estate) might also be considered. It's even possible to make annual gifts of the premium amounts to the beneficiary/policy owner and utilize your gift tax exclusions.

#### Gift of an Existing Policy

You may own an insurance policy that has a substantial cash surrender value, yet the original purpose for the protection no longer applies. The policy might have been purchased initially to provide financial security for a spouse now deceased, to

educate children now grown or for liquidity to pay death taxes when liquid assets were in short supply. This policy can be a sort of hidden asset, available to be used for your philanthropic purposes.

If you choose to name our organization as the beneficiary of a policy that is not paid up and also assign all incidents of ownership of the policy to us, several good things happen. You receive an immediate income tax charitable deduction for the “interpolated terminal reserve” value of the policy. This is an updated cash surrender value, a figure available from the insurer.

If you itemize deductions on your tax return, your actual income tax savings depends on your marginal tax rate. A person who does not normally itemize may find the additional charitable deduction boosts his or her total itemized deductions above the standard deduction.

For a paid-up policy, the deduction is the cost of replacing the coverage with a comparable policy. In either situation, the tax deduction cannot be greater than your net investment in the policy (total premiums paid less any dividends received). The charitable deduction is reduced by any outstanding balance of a policy loan, which may also be considered additional taxable income.

When death benefits under the policy are removed from a taxable estate, there may be a future estate tax savings if your estate would have otherwise been subject to tax.

If premiums on the policy are still payable, there are two options to be considered. You may stipulate that the assignment

of ownership of the policy at its current value is the total charitable gift, immediately available for our use. In that case, we might surrender the policy for cash. Or we might decide to accept an amount of paid-up insurance. In either case, you are relieved of the obligation to make further premium payments.

However, an alternative may be even more attractive. The policy can remain in force so that the larger, original face amount will become your gift. You pledge to make unrestricted gifts at least annually, which we will use to pay the premiums. The gifts are deductible, and the policy is thereby kept in force with pretax instead of after-tax dollars for a lower actual cost.

A further potential advantage is to make annual gifts in the form of marketable capital gains property otherwise to be sold, such as appreciated stock. Avoidance of the capital gains tax is a second tax savings, not possible when paying premiums directly to the insurer.

Payments of the premiums directly to the company, instead of comparable gifts to us, are considered to be gifts “for the use of” instead of “to” us. If made in cash, the gifts are deductible only up to 30 percent of adjusted gross income for the year, rather than up to a 50 percent annual limitation.

#### Use of Beneficiary Clause as a Revocable Gift Arrangement

Other options are available if you would rather retain ownership of a policy as an asset for your own financial security or that of others. They include the following.

- naming us as the only or a partial primary beneficiary of the policy, with the right to change the beneficiary clause as owner of the policy;
- naming us as the contingent successor beneficiary, receiving the death benefits only if a named individual beneficiary predeceases you;
- creating a separate trust named to receive death benefits, with terms providing first for financial support of one or more named individuals for specific terms of years or for life, after which the trust terminates and its assets pass to us;
- naming us as the residual beneficiary of an annuity settlement option available under some policies.

These plans do not produce a current income tax charitable contributions deduction, but they can provide the satisfaction of knowing we will receive some benefits if certain events take place and the arrangement is left unchanged. Any amounts payable to us at your death will not be subject to federal estate tax.

#### New Policy for Future Charitable Gifts

Many of our friends and regular donors who would like to make a significant future gift to us at a relatively low cost can do so through a new life insurance policy. With increasing longevity, older persons can now purchase insurance at more affordable premium costs than were possible in the past. Retired individuals enjoying a surprisingly high standard of living can use some annual discretionary income to perpetuate their support of our work, without depleting their financial reserves or reducing the projected inheritances of family members.

In most states, you can enter into a new insurance contract with a qualified charitable organization like ours as both the beneficiary and owner of the policy. Gifts to us to cover premiums are deductible for those who itemize and can be in the form of capital gain property for a second tax savings.

Greater leverage is possible when two donors, usually wife and husband, purchase a two-life, second-to-die policy. With two lifetimes before payment of benefits, a desired future gift to us can be obtained for substantially fewer premium dollars. These policies are available even if one spouse is not insurable and are generally more economical than a policy only on the insurable spouse.

A type of insurance sometimes used by charitable donors is a policy for which a specific number of years of premium payments is projected—but not guaranteed—after which the premium obligation “vanishes.” It should be kept in mind that the premium requirement may continue for a longer period, or even vanish and then reappear, if the policy cannot generate the assumed internal return required to keep the policy in force.

Covering premium costs with annual gifts to us for an extra year or two will increase values and lessen the possibility of renewed premium payments or a reduced paid-up amount of benefits. Policies that are not so interest-sensitive should be considered as an alternative.

#### What About Term Insurance?

Term insurance, such as coverage by a group policy through your employer, has no cash value, so assigning ownership would have no tax advantage.

When term coverage is provided by your employer, the cost attributable to any coverage in excess of \$50,000 may be included in your taxable income. However, if we are the sole beneficiary under the policy, such cost is not included in your taxable income, nor will benefits be part of your estate.

Term insurance can be used to guarantee the payment of a substantial pledge of gifts to us payable over a period of years, without potentially obligating your estate. The term life insurance policy on you, the donor, can be reduced annually as installments are paid on the pledge, with the policy dropped when the gift is complete.

#### Creating an Irrevocable Life Insurance Trust

At the beginning of this brochure, we discussed the purchase of life insurance as a means of replacing for your heirs the value of a gift to us. We covered situations in which you assign the beneficiary as owner of the policy. For larger amounts and multiple heirs, an irrevocable life insurance trust (also called a wealth replacement trust) may be preferable as owner of the policy, typically with a bank trust department or trust institution as trustee.

An insurance wealth replacement trust can work well in conjunction with a charitable remainder trust. When you establish a charitable remainder trust, you fund it with assets that will provide you (or another beneficiary) income for life, and then we receive the remainder. Besides the initial income tax deduction for funding the trust and the resulting tax savings, your income from reinvested trust assets is typically improved,

and often it's a way to avoid capital gains tax liability. These savings free money for contributions to the trust to pay insurance premium costs.

When the trust ends, its assets pass to us, or to more than one charitable organization in accordance with your wishes, without being subject to tax. The life insurance death benefits pass to heirs from the wealth replacement trust untaxed, having previously been transferred as annual gifts to heirs covered by gift tax exclusions, use of credits or reduced gift tax payments.

To avoid a federal gift tax on contributions to the trust to cover premium costs, the insurance beneficiaries can be given a temporary right to withdraw each contribution for their own direct use. These "Crummey powers" (named after a court case) qualify the transfers as present interests that can utilize annual federal gift tax exclusions. While it would thwart the estate plan if the heirs exercised those powers, their right to withdraw may not be restricted orally or in writing.

### Find Out More

At this level of family and philanthropic distributions, it is especially critical to have a skilled planning team with expertise in finance, law, taxes and insurance. The benefit of the best advice possible is well worth the cost.

Also, our own knowledge of charitable giving methods is available for you and your advisors, with no obligation.

The information in this publication is not intended as legal advice. For legal advice, please consult an attorney. Figures cited in examples are based on current rates at the time of printing and are subject to change.