Gifts of Life Insurance

Effective Ways to Make Them

If you have a desire to make a major contribution to support our good works, life insurance can be an excellent tool for helping you accomplish your philanthropic goals while achieving other important financial objectives. In fact, life insurance can empower many individuals to make charitable gifts they never would have thought possible.

Life insurance can be an excellent means of providing a major future benefit for a charity. A gift of life insurance can provide the donor with tax and financial benefits at a relatively modest after-tax cost.

However, sometimes an individual is strongly motivated to make a significant gift to charity but is constrained from doing so by family considerations. After all, if the donor makes a lifetime gift, family members may be deprived of assets they will eventually need. "Wealth replacement" is a technique that has evolved to address this issue.

Read on to learn about the ways you can use life insurance to make cost-effective outright gifts to charity and explore how the wealth replacement technique allows donors to make a major impact with their giving.

Low-Cost Major Gift Opportunities

As noted, life insurance provides an excellent opportunity to make a potentially major future gift to our institution at a modest after-tax cost (or no immediate out-of-pocket cost for a gift of an existing policy). By assigning the ownership of your life insurance policy to us, you can take an income tax charitable deduction equal to the fair market value of the policy or the cost basis, whichever is less. Plus, if you continue to pay the remaining premiums on the policy, you can deduct those payments as charitable contributions.

How an Outright Gift Works

It's quite simple to make a gift of life insurance. If you are the insured-policyowner, simply transfer the policy to us and file an absolute assignment-of-ownership form with your insurance company. Your insurance company will send us an endorsement showing that we are the sole owner and beneficiary of the policy.

Example: Bob owns a $100,000 life insurance policy with a cash value of $12,000. He can ensure that our institution will receive $100,000 at his death by assigning the policy to us and making annual gifts for the payment of future premiums.

Bob can deduct the fair market value of the policy immediately for income tax purposes (or his cost basis in the policy, if that amount is less). He also can deduct later gifts he makes to us to help pay the remaining premiums, and the proceeds from his policy will not be subject to the federal estate tax at his death.

Other Effective Ways to Give

There are other gift arrangements of life insurance you may want to consider.

You can simply name our institution as the beneficiary of a policy. Or, if you think that a family member should have priority as a beneficiary, you can name us as the contingent beneficiary so we receive the proceeds only if the chosen family member is not living at the time of your death.

You may also acquire a new policy and then transfer ownership of the policy to us. All the premiums you pay are tax-deductible charitable gifts. A popular arrangement is to purchase a policy that will be paid up in a few years. In many cases, the after-tax cost of a generous future gift is only a fraction of the benefit provided to our institution, without decreasing the estate you want to leave to other beneficiaries.

You may want to consider the tax and financial rewards of transferring a policy to a charitable remainder trust. The trust will pay an income to your beneficiary for life. At the death of the beneficiary, any remaining proceeds will pass to us.

A charitable remainder trust allows you to immediately deduct the present value of our remainder interest as a charitable contribution. Furthermore, the policy proceeds will avoid probate, will not be reduced by estate administration expenses, and will be immediately available to begin paying an income to your spouse, child, or other named beneficiary.

A Word of Caution

In some situations, a charitable organization may not be considered to have an "insurable interest" in the insured. This means that the charity cannot apply for and be the original owner of a policy on the donor's life. In this situation, the donor may be able to apply for the policy and then transfer ownership to the charity. Check with your attorney about the law in your state.

Replacing Assets Donated to Charity

One deterrent for many individuals wanting to provide major financial support to our institution is fear of depriving their family of assets they may need someday. This presents a classic dilemma of competing family and charitable objectives. Fortunately, the "wealth replacement" (or "capital replacement") technique has evolved to help individuals achieve both objectives. It can also provide significant income tax and estate tax savings.

Wealth replacement involves the combined use of:

- A charitable remainder trust,
- A life insurance policy, and
- An irrevocable life insurance trust.

Although it may sound complex, wealth replacement is a very effective way to achieve both family and philanthropic financial goals, while minimizing income and estate taxes, and—in some cases—capital gains taxes.

The following example demonstrates the rewards and benefits of the wealth replacement technique.

Case Study

Mary, age 72, owns marketable securities worth $500,000. She purchased the securities many years ago for $100,000, and the holdings are producing income of around $12,500 each year (a 2.5 percent return). Mary has considered selling the securities and reinvesting the proceeds to obtain a higher income, but she is not happy about the capital gains tax that she would have to pay. Ultimately, Mary would like to split the property or the sale proceeds in her will among her three grandchildren. Furthermore, Mary is committed to making a significant gift to our institution, but not at the expense of her grandchildren.

A Logical Solution. First, Mary transfers the securities to a charitable remainder unitrust that will pay her an annual income of five percent of the value of the trust assets as re-valued every year. Payments continue for as long as she lives. Mary can take a charitable tax deduction for the present value of the charity's remainder interest in the trust. She will also avoid the potential capital gains tax on the transfer to the trust.

Second, Mary creates an irrevocable life insurance trust (ILIT). She funds the ILIT with savings generated by the charitable income tax deduction and her income from the charitable remainder unitrust. As grantor of the ILIT, Mary names her grandchildren as equal beneficiaries of the trust. The trustee of the ILIT will purchase a life insurance policy on Mary's life in the amount of $500,000 (or more) to replace the value of the securities she donated to the charitable remainder trust. Every year, Mary makes a gift to the ILIT to pay the life insurance premiums.

At Mary's death, the charitable remainder trust will be dissolved and our institution will receive the remaining assets. Mary's grandchildren will receive the $500,000 insurance proceeds, and the irrevocable life insurance trust will either terminate or hold and invest the insurance proceeds for the benefit of the grandchildren.

Consider These Benefits

- Mary fulfills her life-long desire to make a substantial gift to our institution.
- She maintains the size of the gift passing to her grandchildren.
- She avoids an immediate capital gains tax liability when transferring the appreciated securities to the charitable remainder unitrust.
- She takes an income tax charitable deduction in the year she transfers the securities to the charitable remainder unitrust.
- Neither the transferred securities nor the life insurance proceeds will be included in Mary's gross estate for federal estate tax purposes, potentially saving her heirs thousands of dollars.

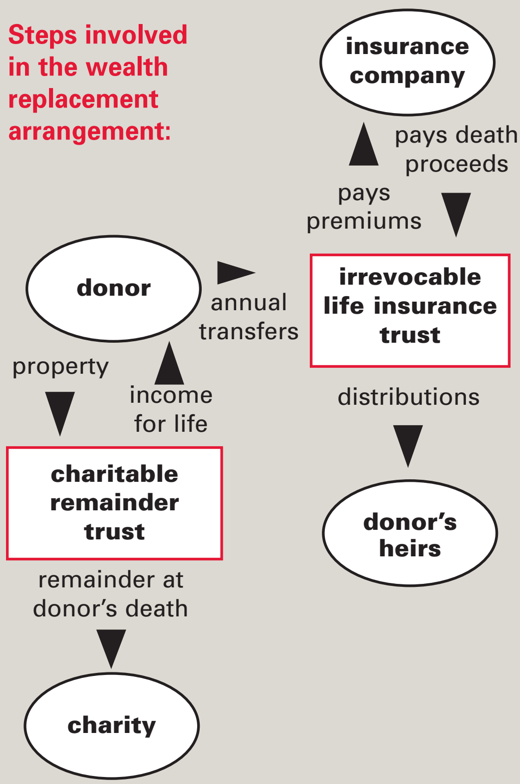
THE WEALTH REPLACEMENT ARRANGEMENT

- The donor transfers long-term appreciated property to a charitable remainder unitrust (CRUT) and receives a federal income tax deduction for the present value of the charity's remainder interest, subject to limitations.
- The CRUT pays the donor an income for life, or for a term of years not to exceed 20.
- The trustee of the CRUT can sell an asset without paying capital gains tax.
- The donor uses the income from the CRUT to make gifts to an irrevocable life insurance trust (ILIT). The trustee of the ILIT can use the gifts (after the beneficiary's right of withdrawal has expired) to help pay premiums for a life insurance policy on the donor's life owned by the ILIT. The initial face amount of the policy is often the fair market value of the property transferred to the trust.
- When the donor dies, the ILIT receives the policy death proceeds, and the charity receives the property in the CRUT.

RESULT: The donor receives a current income tax charitable deduction and increased cash flow for life. The donor's heirs are "made whole" with life insurance that replaces the donated capital, and the donor makes a significant gift to charity.

As you can see, the arrangement is not as complicated as it may have first appeared. You will, however, want to seek the advice of knowledgeable estate planning professionals. They are in the best position to advise you of the appropriateness of this plan for your own situation.

Steps involved in the wealth replacement arrangement:



- Mary's grandchildren will receive the life insurance proceeds income tax free.
- Essentially, Mary will be able to make two major gifts with the same asset—one to her grandchildren and one to our institution!

A Final Word

If you would like to plan a satisfying and tax-rewarding gift of life insurance or develop a plan for wealth replacement, we are happy to help. We are available to answer any questions you or your financial advisors may have and to provide additional information.

Tax information provided herein is not intended as tax or legal advice and cannot be relied on to avoid statutory penalties. Always check with your tax and financial advisors before implementing any gift.

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