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Charitable Giving Through Life Insurance – The Other Right Stuff

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In Tom Wolfe's 1979 book, "The Right Stuff" he celebrates the qualities of the test pilots that became our first astronauts. In doing this he likened them to warriors who receive the honor and adoration of their people before going into battle on their behalf. This brings to mind another kind of right stuff mirrored in the character of those that go forth to better our world through their charity. While less celebrated, if you wonder at the significance of what they do consider the words of Margaret Mead who said:
"Never doubt that a group of thoughtful, committed citizens can change the world. Indeed it is the only thing that ever has."

So now you may be wondering what all of this has to do with life insurance. The answer is that life insurance is the tool with the right stuff for people with the right stuff that want to make a difference. This is because it is the only financial instrument that enables us to leverage our good to the one or the many. Indeed it is intended by design to do that through premiums representing pennies on the dollar, tax deferred cash values and income tax free death benefits. In essence, if you want to make a difference, give but if you want to make a big difference give through life insurance.

The specific advantages of giving to a charity through life insurance are:

- The death benefit is generally many times larger than the total premium payments.
- The life insurance allows the donor to make a significant gift without reducing their estate and depriving their family of an inheritance.
- It is better to give property to charity during your life rather than leaving it to charity at your death because the lifetime gift results in an income tax deduction.

With the above advantages in mind there are the following three choices when gifting life insurance to a charity. They are:

- Making a gift of an existing policy.
- Name the charity as a beneficiary.
- Setting up the policy with the charity as owner and beneficiary.

Regarding the making of a gift of an existing policy, if a donor has excess life insurance that they no longer need they can transfer it to a charity. The result will be a charitable contribution deduction in an amount that is the lesser of the policy's fair market value or its cost basis. For this purpose the fair market value is determined as:

- Paid up or single premium policy – replacement cost
- Premium paying policy – interpolated terminal reserve (Any subsequent premium payments by the donor are deductible.)

Alternatively, if the donor wants to maintain flexibility they can retain ownership of the policy and just name the charity as the beneficiary. The result would be that:

- The donor can change the beneficiary.
- No income tax charitable deduction is available for premium payments.
- The death proceeds are included in the donor's gross estate but an offsetting estate tax deduction is available for the death benefit.

If the donor's preference is to make a charity the owner and beneficiary of a new policy the preliminary question is whether the charity has an insurable interest under state law. In a state where the charity does not have an insurable interest the donor could apply for a policy and then transfer it to the charity. Here it should be noted that in some states the beneficiary must also have an insurable interest in the insured's life. In any case, assuming that the charity has an insurable interest, the charity applies for the policy and pays the premiums with gifts from the donor that are deductible by the donor for federal income tax purposes as charitable gifts.

Besides making a charity the owner and beneficiary of a new policy an individual can make a charity the beneficiary of their employer provided group term life insurance. In that situation, the Table I cost of the coverage in excess of $50,000 will not be taxed to the insured individual. This means that without having to make an outlay of personal funds the donor provides the charity with a death benefit.

In addition, a donor can name a charity as the beneficiary of a term rider. This may be done when purchasing a cash value policy by adding a term rider and naming the charity as the beneficiary of the rider. Such an approach is a simple and cost effective way of benefiting the insured's family and a charity. Further, the insured retains control of the coverage and can change the beneficiaries.

Due to the loss of future gifts and services upon the deaths of donors, board members or key employees a charity may want to purchase insurance on the lives of such individuals as a form of cushion. Further, such individuals who appreciate the importance of their contributions may be a source of funds to pay for the coverages.

It should be noted that potential donors are sometimes hesitant to make gifts to charity because of their concern that family members may feel deprived of their inheritance. A solution to that problem is for an individual that gives property to a charity to replace that property for their family by establishing a wealth replacement trust. This is an ILIT holding an amount of life insurance that the donor wants to use to replace property given to the charity. Income tax savings from the charitable deduction plus an income stream from some forms of charitable gifts like Charitable Remainder Trusts and Charitable Gift Annuities can help to fund the donor's gifts to the ILIT to cover premiums.

A word of caution is in order with regard to gifting a policy to a charity that is subject to a loan. In those situations the transaction will be viewed by the IRS as part sale and part gift. This means that the donor will always have some amount of taxable gain where the loan balance exceeds the donor's basis in the policy.

In closing, for those who may wonder about the right stuff through charity there is a quote from the author James Baldwin who said, "We are responsible for the world in which we find ourselves, if only because we are the only sentient force which can change it." Add to that the line from Anne Frank's diary, "No one ever became poor by giving.

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