



Marketplace

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The *WRMarketplace* is created exclusively for AALU Members by the AALU staff and Greenberg Traurig, one of the nation's leading tax and wealth management law firms. The *WRMarketplace* provides deep insight into trends and events impacting the use of life insurance products, including key take-aways, for AALU members, clients and advisors.

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TOPIC: Happy Holidays: A Few Simplified Charitable Giving Approaches Using Life Insurance

MARKET TREND: Given the ease of using life insurance, charitable giving can be a popular year-end topic for clients looking to satisfy both philanthropic and tax planning goals.

SYNOPSIS: As clients search for ways to make their year-end charitable contributions, a gift of life insurance may be an easy solution. A life insurance policy is easily transferable and, among other benefits, can provide a fixed-value gift with minimal administrative requirements, financial flexibility for the donor, and a highly favorable cost-to-benefit ratio. Simple options for giving a life insurance policy or the proceeds to a charity include: (1) a direct gift of a policy to a charity, (2) making annual gifts to a charity for it to purchase and pay premiums on a policy, (3) naming a charity as the policy beneficiary, or (4) adding a charitable giving policy rider. Each of these options may significantly enhance a donor's ability to meaningfully provide for charity.

TAKE AWAYS: Regardless of whether clients desire to maintain control over a policy during life, foster an on-going relationship with charity, or make a one-time gift with no

further attachments, combining simple gifting techniques with life insurance can enable charitably-minded clients to achieve significant philanthropic and tax planning goals at minimal investment and administrative cost.

PRIOR REPORTS: 12-27; 13-25.

As clients search for ways to make their year-end charitable contributions, a gift of life insurance may be an easy solution. While discussions regarding charitable giving and life insurance often trend towards more complicated split-interest gifts using charitable trusts (see WRMarketplace Nos. 12-27 and 13-25 for a discussion of these planning options), such complexity isn't always needed or desired by clients to achieve their philanthropic goals, particularly if they wish to act by December 31st. In these cases, direct methods for gifting life insurance policies or the policy benefits may be the simplest and most effective ways to proceed.

WHY LIFE INSURANCE

Gifts of life insurance can provide several benefits, depending, as discussed below, upon the method of making the gift, the ultimate policy owner, and whether the policy is paid-in-full or requires further premium payments.

Fixed-Value Gift. Unlike giving other assets, such as real estate or marketable securities, life insurance death benefits provide a fixed-value gift that is not subject to depreciation or erosion by maintenance and administrative costs, taxes, or fees. Further, if the charity owns the policy, its receipt of the full contracted death benefit is contingent only upon the payment of premiums (if any) and is not conditional or subject to donor revocation. Further protection in the form of a disability waiver of premium rider may be available to guarantee the gift to charity in the event the donor becomes disabled and is unable to make required premium payments.¹

Simple Administration. For donors with existing policies, the assignment of the policy to the desired charity is a relatively simple and inexpensive process. Naming a charity as the policy beneficiary is even more straightforward. Further, during the policy term and life of the insured, other than the payment of policy premiums (if any), there are no annual administrative requirements for either the insured or the charity. Upon the insured's passing, the death benefit will be paid directly to the charity, as beneficiary, without the delay and administrative inconvenience of probate administration. The benefit will be liquid and may be used by the charity as desired, without the need for ongoing maintenance and administration.

Favorable Cost to Benefit Ratio. Regardless of how or when premiums are paid, the total premiums paid for a policy are likely to account for only a fraction of the actual death benefit paid to a charitable beneficiary upon the insured's passing. Thus, depending on the form of the contribution, a charitable gift of life insurance can operate somewhat like a leveraged pledge agreement.

Example.² Joe, a 60-year old philanthropist, acquires a \$15 million life insurance policy on his life and immediately (and irrevocably) assigns the policy to Charity X. He makes three payments aggregating \$1.7 million over a period of three years to Charity X, which in turn uses the donations to pay the policy in full. Though Joe only contributed \$1.7 million of his personal assets, Charity X will receive a guaranteed gift of \$15 million upon Joe's passing.

Financial Flexibility. Giving life insurance can offer more flexibility to the donor than other forms of gifting. The donor can decide between simply naming a charity as the policy beneficiary, adding a charitable giving policy rider to the policy, or giving the policy to the charity (and further decide whether to give a fully-paid up policy or one that will require additional premiums). If ongoing premiums payments will be required, depending on the policy, flexibility can be incorporated regarding the amount and timing of premium payments, but the donor will never be required to make an immediate lump sum payment of the full, intended charitable gift (i.e., the policy death benefit).

Enhanced Relationship Between Donor and Charity. A gift of a life insurance policy to a charity that a donor will continue to fund with ongoing charitable contributions can encourage a long-term relationship between the charity and the donor. Each time the donor makes a contribution to the charity to support the payment of the annual premiums, the charity can enhance this relationship by providing the donor with annual recognition.

KEEP IT SIMPLE

Simple methods for giving life insurance to accomplish a client's philanthropic goals include giving a policy to a charity, making contributions to a charity so that it may buy and pay premiums on a policy, or naming a charity as the beneficiary of a policy or a charitable giving rider to a policy.³

Charitable Gift of Policy. A donor may acquire a policy on his or her life and then irrevocably assign ownership and all incidents of ownership⁴ with respect to the policy to a charity.⁵ Alternatively, if applicable state law provides the charity with an insurable interest in the donor as further discussed below,⁶ a charity may acquire the policy directly from the insurer, bypassing the need for a policy assignment (and the potential estate tax issues, if the donor dies within three years of assignment of the policy). The charity becomes the policy owner and beneficiary, and, if required, the donor can pay any ongoing premiums (either directly to the insurer or to the charity). The charity receives a financial benefit both from access to the policy's cash value, which may be withdrawn or borrowed, and, later, upon the donor's passing, from the policy's death benefit.

Gift of Paid-Up Policy.

Reasons to Consider. Giving a paid-up life insurance policy to charity effectively eliminates annual administration requirements for both the donor and the charity. With a paid-up policy, there is no need for the donor to coordinate ongoing annual premium payments or obtain contemporaneous annual receipts from the charity for the purpose of taking a charitable income tax deduction.

With respect to the donor, he or she may take a charitable income tax deduction in the year of the gift. For a cash gift to fund a single premium policy, the amount eligible for deduction will equal the value of the gift. If a gift is of a paid-up policy, the amount eligible for deduction will equal the lesser of the policy's fair market value or the donor's adjusted basis in the policy on the date of the charitable contribution.⁷ Also, assuming the donor retains no incidents of ownership and survives the gift of the policy to charity by three years, the death benefit will not be included in the donor's taxable estate.⁸

Potential Issues. For a donor to take advantage of the potential income and estate tax benefits of gifting a life insurance policy, the donor must strictly abide by valuation requirements and relinquish all control over and any benefits in the policy (including lifetime access to policy cash value). Further, to receive a current charitable income tax deduction, a gift of a life insurance policy must be properly valued and substantiated by obtaining a qualified appraisal of the policy at the time of the gift if the policy has a perceived value of \$5,000 or more.⁹ Although the policy's value typically equates to the amount that the insurance company would charge for a single premium policy of the same death benefit, the value of the gift may be substantially

higher if the insured is terminally ill, as the policy is arguably worth more than it would be under normal circumstances.¹⁰

If a donor retains any beneficial interest in the gifted policy, the donor may not take a deduction for the value of the gift. In addition, if the donor continues to hold incidents of ownership with respect to the gifted policy, or fails to outlive the absolute transfer of policy ownership to the charity by at least three years, the policy will be includable in the donor's taxable estate at passing.¹¹ Although the donor's estate tax liability with respect to the death benefit would be offset by the unlimited estate tax charitable deduction,¹² the inclusion of the policy in the donor's estate may cause the estate to fail to qualify for certain benefits which may otherwise be available to an insufficiently liquid estate.¹³ Inclusion of the policy in the donor's estate may also result in the consideration of the policy proceeds for the purpose of determining a surviving spouse's elective share.¹⁴

Gift of Policy with Ongoing Premiums.

Reasons to Consider. A donor's gift of a policy subject to future premiums may be more desirable than giving a paid-up policy to charity for both financial and strategic reasons. The charity will still benefit from access to the policy's cash value as it accrues during the donor's life, and from the policy's death benefit upon the donor's passing. Also, assuming the donor makes an absolute and irrevocable transfer of the policy to the charity, the policy will not be includable in the donor's taxable estate.

Unlike a paid-up policy, however, the donor may spread out the charitable income tax deduction by claiming a deduction for the value of the policy for the year of the gift, as well as annual deductions for the premium payments paid to or for the benefit of the charity,¹⁵ subject to the applicable deduction limitations.¹⁶ In satisfying the premium payments, the donor has the option to make annual contributions to the charity in support of each annual premium, or pay the premiums directly to the insurer for the charity's benefit. Both the donor and the charity may also find this arrangement more desirable as it encourages an ongoing relationship between the donor and the charity, and will likely result in annual recognition of the donor by the charity.

Potential Issues. If the donor makes a gift of a policy requiring on-going premiums (rather than making donations that allow the charity to purchase the policy directly), the same income tax and estate-related consequences of a donor's retention of incidents of ownership with respect to a gift of a paid-up life insurance policy will apply. In addition, deductions for gifts to or for a charity for the purpose of keeping a

life insurance policy in-force are subject to substantiation requirements. To ensure that each gift is deductible to the maximum extent permitted, the donor must receive a contemporaneous written receipt from the charity to substantiate each premium payment,¹⁷ and the donor may not condition any gifts to the charity in support of the premiums upon the actual payment of policy premiums by the charity.¹⁸

Naming Charity as Beneficiary of Policy or Charitable Giving Rider. A donor may name a charity as a primary or contingent beneficiary of a life insurance policy. The donor will remain the policy owner and will retain all rights and beneficial interests with respect to the policy. Upon the donor's passing, the death benefit will be paid to the charity. Alternatively, a donor may add a charitable giving policy rider to a policy. A charitable giving policy rider is a life insurance policy rider that can be attached to a policy with a face value of over \$1 million, typically at no additional cost to the policy owner. The rider may provide for incremental payment at 1% of the policy's face value to a charity designated by the policy owner. After addition of the rider, there generally are no additional administrative requirements, no cost or premium increases, and no decrease in the cash value of the death benefit with respect to the policy.¹⁹

Reasons to Consider. The level of flexibility afforded to the donor by retaining ownership of the policy is the primary advantage to this method of gifting insurance. As policy owner, the donor can change the beneficiary at any time should health, financial, or familial circumstances change. The donor also will retain access to the policy's cash value. Potential delays and costs associated with probate administration will also be avoided, as contractually, the policy proceeds should be paid directly to the charitable beneficiary at the insured's death.

Potential Issues. As the donor retains incidents of ownership in the policy, no charitable income tax deduction is allowed for either payment of premiums or the fair market value of the policy. The policy will be included in the donor's taxable estate,²⁰ but the inclusion should be somewhat offset by the unlimited estate tax charitable deduction.²¹ Note, however, that the charity generally **should not be named as an irrevocable beneficiary** of a policy owned by the donor since, under such circumstances, the donor would receive no charitable income tax deduction, and the donor loses the flexibility of being able to alter beneficiaries if circumstances change.

TAKE AWAYS

Regardless of whether clients desire to maintain control over a policy during life, foster an on-going relationship with charity, or make a one-time gift with no further

attachments, combining simple gifting techniques with life insurance can enable charitably-minded clients to achieve significant philanthropic and tax planning goals at minimal investment and administrative costs.

NOTES

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¹ For an additional cost, the donor may acquire a disability waiver of premium policy rider that will take effect upon certification of the donor's total disability for a designated period of time. During the period of disability, the life insurance policy will remain in force and the full benefit (and in some cases the policy's cash value) will be guaranteed, even if the donor dies early in the policy term. See Brink, Michael and Brian Clontz, "Charitable Gifts of Life Insurance," *Planned Giving Design Center* 28 Feb. 2008, www.pgdc.com/pgdc/charitable-gifts-life-insurance.

² The various practical and tax considerations of this approach are more fully discussed within this report.

³ See generally. Leimberg, Stephen R. and Albert E. Gibbons, "Life Insurance as a Charitable Planning Tool, Part I," *Estate Planning*, March 2002, Vol. 29, No. 3, Pg. 132 and "Life Insurance as a Charitable Planning Tool, Part II," *Estate Planning*, April 2002, Vol. 29, No. 4, Pg. 196.

⁴ Treas. Reg. §2042-1(c)(4). An "incident of ownership" with respect to a life insurance policy is any right the insured has to the economic benefits of the policy, including the power to change beneficiaries, assign the policy, and surrender the policy.

⁵ The donor's spouse may also purchase the policy on the donor's life and then make an absolute assignment of the policy to charity in order to minimize the risk of the donor retaining any incidents of ownership in the policy.

⁶ With an insurable interest, the initial purchaser (person or entity) of a life insurance policy must have an interest in securing the emotional or economic advantages from the continued life of the insured. Generally, persons or entities unrelated to the insured that are not subject to financial loss from the insured's death do not have an insurable interest and cannot purchase a valid insurance policy on the donor's life. With respect to the insurable interest of a charity in a donor's life, if applicable state law does not recognize that the charity has an interest in the continued life of the donor, then the life insurance contract may not be recognized under federal law and related gifts would therefore not be deductible for federal income tax purposes (Code § 7702; See also Dept. of Treasury, "Report to Congress on Charity-Owned Life Insurance," April 2010). However, many states have adopted legislation recognizing that a charitable organization has an insurable interest in the life of a donor. Accordingly, before making a gift of a policy or for subsequent premiums, the donor should verify that state law will consider the charity to have an insurable interest in the donor's life (*See* Leimberg, Stephen R. and Albert E. Gibbons, "Life Insurance as a Charitable Planning Tool, Part I," *Estate Planning*, March 2002, Vol. 29, No. 3, Pg. 132).

⁷ *See e.g.*, PLR 8042104. The value of a donor's contribution of a fully paid-up group life insurance policy to charity was the fair market value of the policy. *See also* Code § 170(e)(1)(A). The amount of any charitable contribution is reduced by the amount of gain which would be ordinary income had the donor sold the property at its fair market value.

⁸ Code § 2035. If the insured transfers or relinquishes ownership (or any incident of ownership) in a life insurance policy within three years of death, the entire death benefit of the life insurance policy will potentially be included in the insured's estate for estate tax purposes.

⁹ Treas. Reg. § 1.170(A)-13(b) and (c).

¹⁰ *See* Treas. Reg. § 25.2512-6(a). The value of a paid-up policy may be approximated by the interpolated terminal reserve on the date of the gift to the proportionate part of the gross premium last paid before the date of the gift which covers the period extending beyond that date. If, however, because of the unusual nature of the policy such approximation is not reasonably close to the full value, this method may not be used. *See also* Treas. Reg. § 25.2512-6(a), Example (3). A donor owning a life insurance policy on which no further payments are to be made makes a gift of the policy. The value of the gift is the amount that the insurance company would charge for a single premium policy of the same specified amount on the life of a person of the age of the insured.

¹¹ Code § 2042(2), § 2035.

¹² Code § 2055(a).

¹³ *See* Code § 303; Treas. Reg. § 1.303-2. Section 303 applies only where the distribution is with respect to stock of a corporation the value of whose stock in the gross estate of the decedent for Federal estate tax purposes is an amount in excess of (1) 35 percent of the value of the gross estate of such decedent, or (2) 50 percent of the taxable estate of such decedent. *See also* Code § 6166. If the value of an interest in a closely held business which is included in determining the gross estate of a decedent exceeds 35 percent of the adjusted gross estate, the executor may elect to pay part or all of the tax imposed by section 2001 in 2 or more (but not exceeding 10) equal installments.

¹⁴ *See e.g.*, Uniform Probate Code § 2-202 and § 2-203. The surviving spouse of a decedent has a right to take an elective share of the decedent's estate equal to fifty (50) percent of the value of the marital-property portion of the augmented estate. The augmented estate consists of the sum of the value of all property which constitutes the decedent's (1) net probate estate, (2) non-probate transfers to others, (3) non-probate transfers to the surviving spouse, and (4) the surviving spouse's property and non-probate transfers to others.

¹⁵ Rev. Rul. 58-372, 1958-2 CB 99; *See e.g.*, PLR200209020; *Hunton v. Comm'r*, 1 TC 821 (1943); PLR 8708083

¹⁶ Code § 170(b)(1)(A) and (B). Gifts for the "use of" charity are deductible up to 30% of the donor's contribution base, whereas gifts "to" charity are deductible up to 50% of the donor's contribution base.

¹⁷ Code § 170(f)(8)(A). No deduction is allowed for any contribution of \$250 or more unless a written acknowledgment is received from the donee organization;

¹⁸ Treas. Reg. § 1.170A-1(e). If a charitable contribution depends on a future act or event to become effective, you cannot take a deduction unless there is only a negligible chance the act or event will not take place.

¹⁹ *Id.*; Cussen, Mark P., "Using Life Insurance to Make Charitable Donations," *Forbes*, 28 June 2010, www.forbes.com/2010/06/28/life-insurance-charity-personal-finance-insurance-donation.html.

²⁰ Code § 2042(2).

²¹ Code § 2055(a).