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Life insurance as a charitable donation: to gift or not to gift?

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For the 10 year period 2008-2019, the United States was the most generous country in the world, but there has been a 'dip in donations in more recent years', according to the most recent (Oct. 2019) World Giving Index report.[1] This is surprising since the USA has, until recently, been in the longest bull market in its history (March 2009_ February 2020).

Many people make regular gifts to charity but may not have made provisions for charitable bequests in their estate plan. A concern for many who are charitably inclined while alive is that they don't want to gift to charity at their children's and/or grandchildren's expense. Life insurance may provide a solution, providing a method to give more money to charity at lower than actual cost because a gift of $1 costs less than $1, regardless of circumstance. Admittedly, a death is required but this type of donation can be magnanimous and more impactful than the actual premium spent. At the death of the insured, the benefit goes to the charity tax free. The expected date of death, and thus the date of bequest, can vary, but the owner's wishes will ultimately be fulfilled, and the charity will receive the tax-free benefit.

To own?

If the owner of the policy remains the owner *and* insured there is more control by that owner and no need for trusts, complicated ownership arrangements, or multiple policies to have both the children and a charity as the beneficiaries. This scenario is applicable to group employer plans as well.

The advantages of direct ownership by the insured are that: 1) the owner has money going to whom they wish whether a person or a charity; 2) the owner can change the beneficiaries and benefit amounts at any time and 2) the owner has access to the policy's cash value while alive, which can be a valuable source of supplemental income.

The disadvantage is that the value of the proceeds, no matter who is the beneficiary, must be included in the owner's gross estate because the owner possessed incidents of ownership in the policy at the date of their death.

To gift?

For an individual to gift a life insurance policy both the policy owner and beneficiary must be the same and the individual is the insured. The charity is named as the owner and sole beneficiary and is entitled to receive the proceeds at the death of the insured. The charity, as the policy owner, cannot change the beneficiary and the insured gets the tax deduction for the years that the premium is paid. This obviously is more limiting and as an advisor one needs to be sure the owner and therefore the beneficiary is an institution that the insured feels will last in perpetuity and the insured's convictions about the charitable institution will be unwavering. Depending on actuarial tables this could have an impact on a client's decision. A tool to evaluate charitable organizations is guidestar.org-a free non-profit database resource.

The advantages of gifting a life insurance policy by the insured are that: 1) the owner has money going where and to whom they wish; 2) tax deduction for the insured annually; 2) the value of the proceeds are not included in the owner's gross estate at death, and; 3) the charity can access the cash value before the insured's death.

The disadvantages are that this is an irrevocable decision by your client and your client has no access to the cash value.

Hybrid Option

As always, no decision is black or white. There is a middle ground between gifting and not gifting a life insurance policy to a charity. Aside from the establishment of a charitable trust structure, the owner of the life insurance policy could gift the policy to a community foundation. As a charitable entity itself, the community foundation can act as a middleman to accomplish a number of goals efficiently. The donation to a community foundation could result in a charitable deduction and also allow the owner to maintain some control where an outright gift to an operating charity might not. As an added benefit, the community foundation could also work with the owner to better identify the charitable goals and wishes for the gift. Children and grandchildren can oversee the endowment fund. This hybrid method offers the opportunity to get the best of both worlds.

Win-win?

For both types of ownership, the life insurance policy is a way to give a lot of money to a charity of choice at death.

As an added benefit, the insured person can meet with the eventual charitable beneficiary during life and discuss ways that the insured would like the charity to deploy the proceeds of the policy. The death proceeds can be put into a named endowment fund at the organization as part of the client's legacy. Children and grandchildren can oversee the endowment fund.

Charities may survive on their annual and lifetime gifts, but charities and their endowments really thrive with larger, planned gifts. For example, knowing that $1 million in life insurance proceeds is likely to come in the next few years may allow a charity to engage in long-term and strategic planning in a way that it may not have otherwise been able to do.

Is this right for your client? This basic explanation illustrates a strategy that may achieve an estate planning objective for your client - using life insurance as a technique to benefit a favorite charity and create a bequest that far exceeds the cost.

[1] https://www.cafonline.org/about-us/publications/2019-publications/caf-world-giving-index-10th-edition