

## FROM THE PROFESSIONALS

*From the Professionals is a tri-annual column of finance and investing tips from different members of the professional services industry. The opinions represented here are authorized by the following firm, and may not reflect those of the Pinchot Institute for Conservation.*

## The Gift of Life: Using Life Insurance to Make a Meaningful Charitable Donation

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Life insurance is an ideal medium with which to make a charitable donation. There are a number of ways to donate life insurance, which I'll explain later, and people do so for a variety of purposes. In general, the main reasons are to:

- ✿ make a substantial gift without using assets immediately on hand,
- ✿ avoid paying income taxes on the built-up value on an existing policy, and
- ✿ find a new use for a policy that no longer serves its original purpose, such as one you bought for your children during their youth.

### MAKING A DIFFERENCE

Since charitable donations are so important—particularly during slow or depressed economic climates, such as they one we're in now—it is worth the effort to make a gift, whereby the money is more valuable in the hands of a charitable organization than in your own. For nearly all donations, the tax deductions allowed yields you more in tax savings than you give up, and there are other ways to stretch your gift as well. One important mechanism for extending the significance of your donation is to make it in the form of life insurance.

Life insurance policies are sub-

stantial assets. Given this, they have become an increasingly popular form of gift among those who seek to make a meaningful difference without noticing a sizable dent to their checking accounts. The IRS allows you to donate most kinds of policies—whether fully paid-up, partially paid, or newly purchased—specifically for the purpose of making a charitable donation.

Many people donate policies which, while still valuable, no longer fill their primary purpose. These people have had the good fortune of seeing their children grow up and become educated, and therefore, no longer need the protection that life insurance offers.

During times of specific campaigns, such as a charity's capital or endowment campaign, a gift of life insurance also provides you with an opportunity to convert a series of regular donations into a single, sizable endowment.

### HOW IT WORKS

Below are examples of the sorts of circumstances where life insurance can be an ideal medium for giving.

**Pat K.**, a registered nurse, had regularly contributed a percentage of her income to a charitable organization. While these charitable contribu-

tions were worthwhile, she wanted to see that she had made some tangible difference. Because she couldn't spare major capital, a large gift seemed out of the question. By purchasing an insurance policy for the organization with small monthly payments on the policy, she could see how great an impact her contributions would truly make.



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**Joan B.**, a board member of a large charity, worked full time on its behalf without pay. She knew she'd be an expensive asset to replace, if someone had to be hired, and that her departure would cause a difficult transition. Solution: she gave her organization a life insurance policy on herself. Only then could she contemplate retiring some day, knowing that her work would be carried on.

**Helen and Jim S.**, a couple that operated their own business, wanted to sell their operations and invest in a diversified portfolio. By selling their business, however, they would expose the lion's share of their assets to taxation. Since the couple had been critical to the success of the business, they had insured themselves heavily. By

giving away their policies, they reduced the taxable gain on the sale of their firm.

## TAX IMPLICATIONS

Since the world of life insurance is nearly as complex as the world of taxation, it is not possible to comprehensively summarize the tax implications of a gift of life insurance. My advice is that you get some expert advice on how to structure your donation. The Pinchot Institute's Kendra Miller can give you referrals to a tax attorney as well as information on the Institute's specific policies for accepting such gifts. In general, however, there are two simple rules.

1. If your life insurance policy is fully paid-up, then you can deduct the replacement value of the policy in the year in which you make the donation.

Keep in mind that if you choose instead to cash in the policy, you will have to pay tax on the difference between the total of your premiums paid and the proceeds. As you can see, the policy really is worth more in the hands of a charitable organization, than in yours.

2. If premiums are still being paid on the policy, you may deduct a figure slightly in excess of the cash value, known as the "interpolated terminal reserve." However, you cannot deduct more than the total of all premiums paid, less any dividends.

If the value of the policy contributed (whether fully paid or not) exceeds half of your adjusted gross income, you will have to carry the excess of that donated amount forward on your taxes for up to five years. Similar restrictions apply when the premiums you continually pay on a gift of life insurance exceed 20% of your adjusted gross income. To avoid this limitation, you can donate the amount of the

premiums donated, and let the charity pay the premiums.

In either instance, no estate taxes will be levied on the donated policy. Usually, the value of the donated policy will not be included in your estate. Even in the event that it is included, it will be offset by an estate tax charitable deduction.

## OTHER ADVANTAGES

In addition to those noted above, there are other advantages to donating a life insurance policy to a charitable organization.

✿ If you have a good income, but not large assets that you're able to part with, a gift of life insurance can provide you with an affordable means of creating a valuable asset for the charity of your choice.

✿ A life insurance policy can easily supply the capital you need to endow a special project or to create a memorial fund for a loved one.

✿ With some types of new or existing policies, it is possible to discontinue payments without diminishing the current value of your donation. Dividends flowing from some policies allow you to pay the policy off relatively quickly.

✿ If you want to leave a portion of your estate to a charitable organization, but you don't want to alter your will, you can transfer ownership of all or a portion of your life insurance policy, and name the organization as beneficiary.

✿ Bequests in a will often require an immediate sale of valuable assets to meet the estate's cash requirements. To avoid this necessity, you can establish a life insurance policy that, after donation, adds no cash burden to an estate.

✿ In cases where the recipient does

not immediately cash in the policy, leaving a donation of this sort provides a promise of funding for the charity's future plans and, in some cases, can help endow it in perpetuity.

✿ Suppose an organization depends on your regular gifts for a specific program or general operating support. If something should happen to you, that program may be severely curtailed or even eliminated. A life insurance policy allows you to secure the future of the program you've been supporting for years, thus enabling you to establish a legacy for the charitable organization.

## THAT "EXTRA" POLICY

Does your portfolio include a policy you bought under far different circumstances? Perhaps when you were younger it seemed sufficient, but subsequently, you've had to buy a more extensive policy.

Perhaps you bought a policy to provide funds to cover the taxes on your estate. If you've followed recent tax law changes, you know that estate taxes have been reduced quite significantly and, for many estates, eliminated. As such, you may not need the policy anymore. It may make sense, from the perspective of tax planning, to use the policy to reduce your current income tax burden by making a charitable contribution. During economic times such as these, charitable organizations would greatly appreciate such a thoughtful gift.

For most people who donate life insurance policies, the chief advantage is that it allows the donor to transfer a low-cost asset into a substantial charitable donation. For many of us, making a significant philanthropic contribution is an important life achievement—one that requires care and planning.

A member of our staff will gladly confer with you and your advisors to find the most effective means of leaving the gift of life—one that uses life insurance to ensure a lifetime of service on the part of a charitable organization.

*Mr. Larry Pauley, CFRE, organized Ford Thompson Consulting in 1984. As Executive Vice President, he holds total accountability for all phases of daily operations and travels throughout the country to provide counsel to clients. Mr. Pauley has extensive background in philanthropic fundraising and direct mail marketing for both for- and nonprofit organizations.*

*As a frequent lecturer, he has spoken at regional and national conferences for the Association of Fundraising Professionals, The American Red Cross and The Association for Healthcare Philanthropy. Among his numerous accomplishments, Mr. Pauley has received the Certified Fundraising Executive (CFRE) designation from the Association of Fundraising Professionals.*

*Ford Thompson has provided counsel to nonprofit organizations since its inception. Primary services include consultation on gift acceptance policies and procedures manuals, gift annuity programs, and executive recruiting. The company also produces the Professional Enrichment Series for planned giving advisors, custom planned giving quarterly newsletters and brochures, provides direct mail services, on-site consulting and training for client staff and boards of directors, and conducts feasibility studies.*

