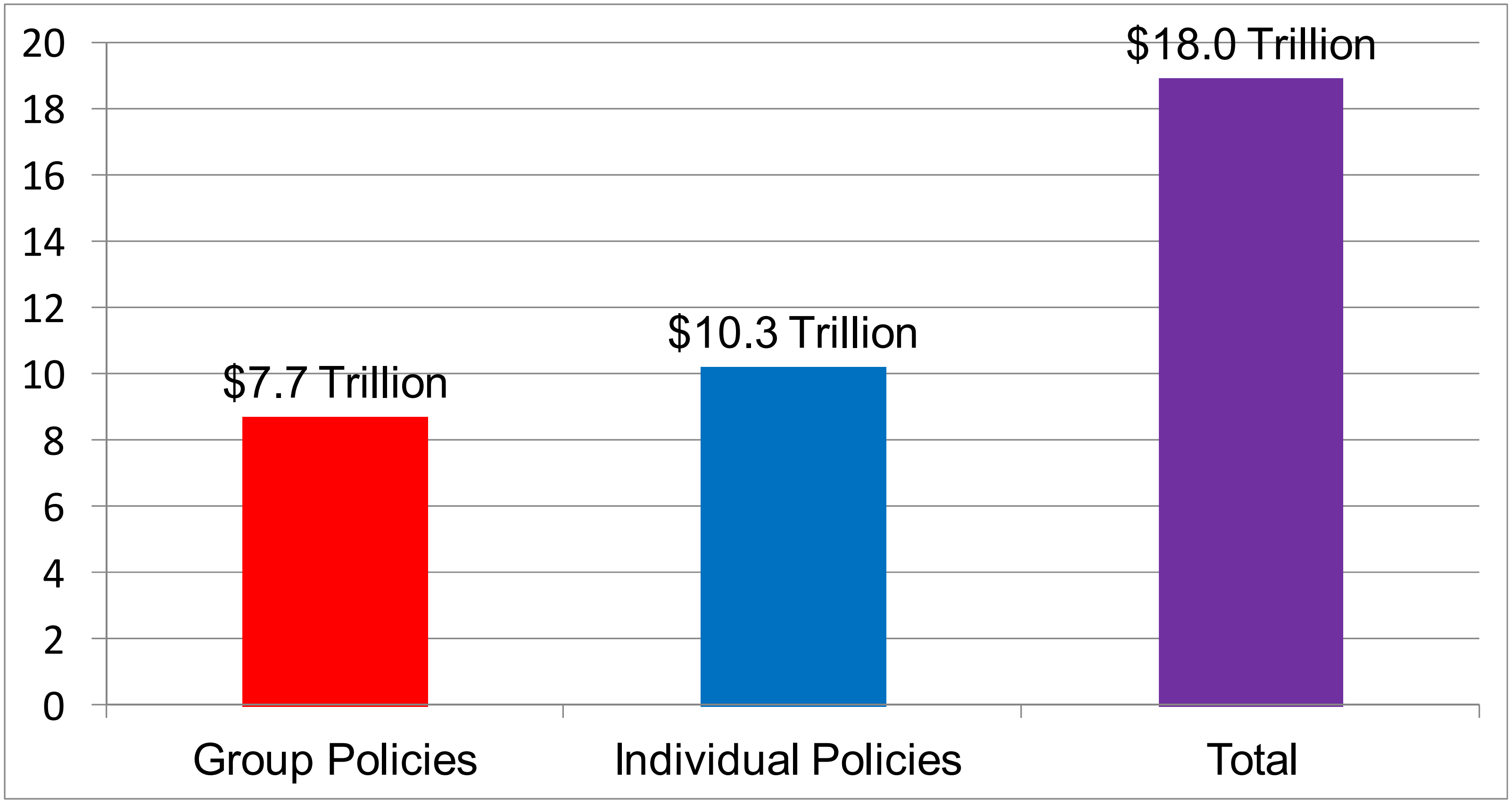
Gifts of Life Insurance

Date:	March 26, 2020
Time:	1:00 – 2:30 Eastern
Presenter:	Gary Pforzheimer President

Agenda

I. Brief primer on types of life insurance
II. Ways to give life insurance and the tax implications of each
III. Practical questions for the gift planner

Life Insurance in Force



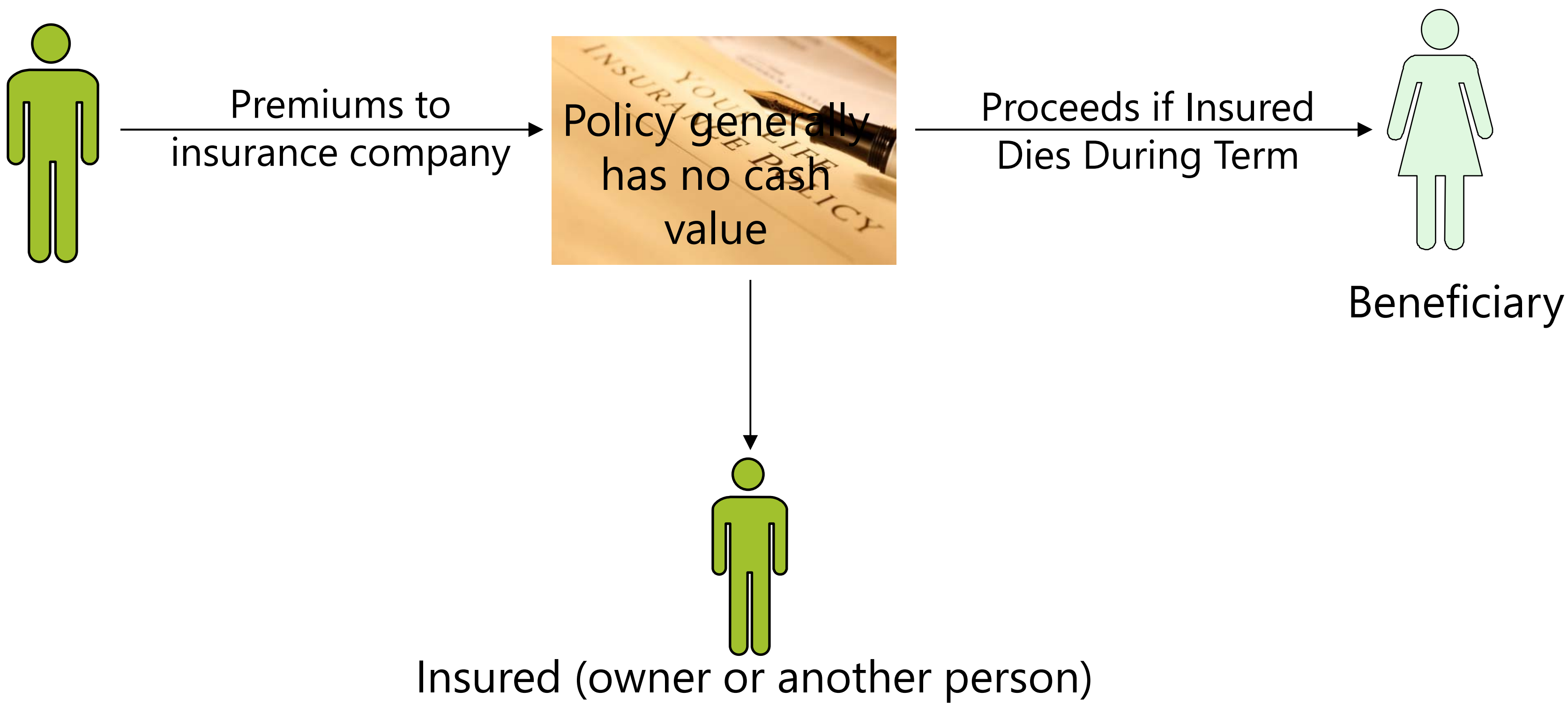
I. Terminology

- Owner
- Insured
- Beneficiary
- Death Benefit
- Insurable interest
- Insurability

Terminology (continued)

- Viatical Settlement
- Life Settlement

Term Life Insurance



Permanent Life Insurance

Premiums to insurance company →

← Cash in case of policy loan or surrender

Owner

Policy Cash value

Proceeds at death of insured →

Beneficiary

↓

Insured
(owner or another person)

Main Types of Permanent Life Insurance

1. Whole Life Insurance
2. Universal Life Insurance
3. Variable Life Insurance

Types of Permanent Life Insurance

Whole Life

- Dates back to at least 1759
- Guaranteed death benefit
- Guaranteed cash values
- Fixed annual premiums

Types of Permanent Life Insurance

Universal Life

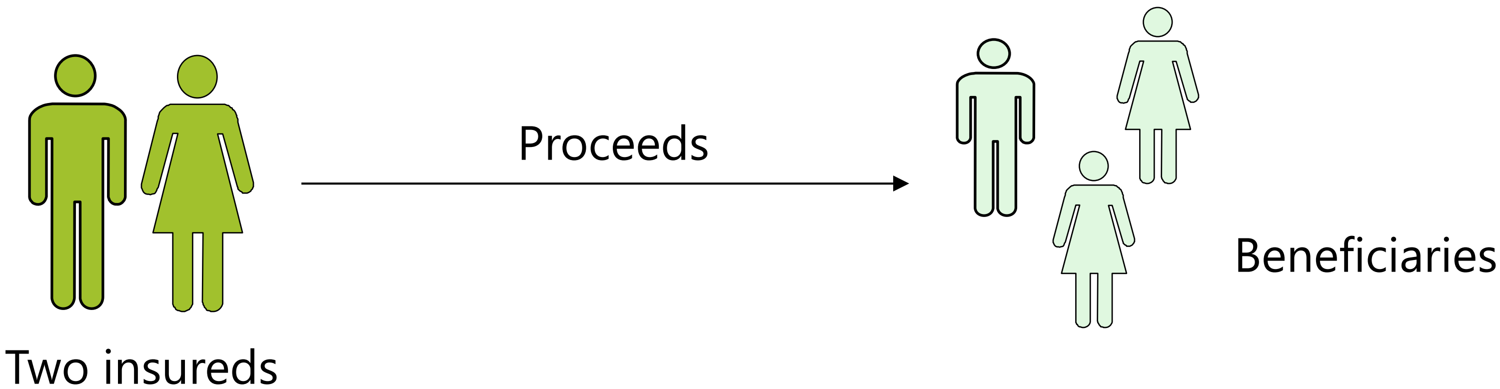
- Introduced in the late 1970's (time of very high interest rates)
- Combination of term insurance and tax-deferred investment account
- Cash value not guaranteed
- Death benefit may vary
- Premium may vary

Types of Permanent Life Insurance

Variable Life

- Variation on whole life and universal life
  - VWL – still contains death benefits guarantees
  - VUL – more popular; no death benefit guarantee
- Portion of premium allocated to separate account
- *Owner selects investments*
- Treated as a security
- Greater risk

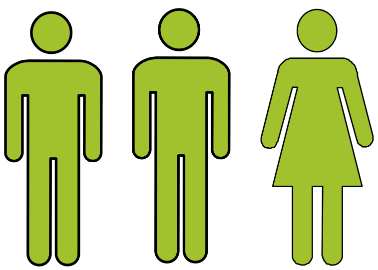
Variation: Second-to-Die Policy



Proceeds paid at death of the survivor of the insureds.

Lower premiums because joint life expectancy longer than single life expectancy.

Variation: First-to-Die Policy



Proceeds →

Beneficiaries
(Individual or company)

Two or more
insureds

Proceeds paid at death
of first insured.

Higher premium because of greater
probability of early death.

II. Ways to Give Life Insurance

Transfer Ownership of Paid-Up Permanent Life Insurance Policy

- **Deduction:** ***<u>lesser</u>*** of (1) the replacement value and
  (2) the adjusted cost basis
- **<u>Replacement value</u>**: current single-premium cost of purchasing equivalent policy. Practically, the cash surrender value (but could be larger)
- **<u>Adjusted cost basis</u>**: total premiums paid less withdrawals, dividends paid, outstanding loans, and mortality charge changes

Paid-up Permanent Policy

Face value	$100,000
Adjusted cost basis	$25,000
Cash surrender value	$48,000
Replacement value (determined by appraisal, based on current health of insured)	$48,000
Deduction	**$25,000**
Immediate value to charity	**$48,000**
Future proceeds	**$100,000**

Paid-Up Permanent Policy

Prospects

- Older
- Is/was a business owner, and/or
- Has grown children

Ways to Give Life Insurance

Transfer Ownership of Existing Permanent LI Policy (premiums still required)

Deduction: ***lesser*** of (1) "interpolated terminal reserve value" and (2) the adjusted cost basis

Interpolated terminal reserve value is

- cash value (the cash build-up) **plus**
- any prepaid premiums and/or expected dividends, **less**
- any outstanding loans

(It is approximately the cash surrender value.)

Existing Policy (premiums required)

Premium Payments

- Deductible by donor ($ for $)
- Paid directly to charity – 60%/50%/30% rule applies
- Paid to insurance company – **may** be deemed “for the use of” and **could** be limited to 30%/20% of AGI

Existing Policy (premiums required)

Face Value	$100,000
Interpolated terminal reserve value	$5,400
Adjusted cost basis	$7,500
Initial charitable deduction	$5,400
Annual charitable deduction for premium contributions	$2,500
Immediate value to charity	**$5,400**
Future proceeds if policy remains in force	**$100,000**

Existing Policy (premiums required)

Prospects

- Older
- Have other assets to meet family and business needs
- LI company may be willing to split a larger policy into two policies – give one, keep one

Ways to Give Life Insurance

Purchase a New Policy, Initially Naming the Charity as Owner

<u>Example</u> (Universal Life Policy)

Face Value	$100,000
Projected total premium payments	$25,000
Projected total charitable deductions	$25,000
Tax savings (28% tax rate)	$7,000
After-tax cost of policy	$18,000
Immediate value to charity	**--0--**
Future proceeds if policy remains in force	**$100,000**

New Policy, Charity as Owner (Universal Life)

Prospects

- Younger (30's, 40's, maybe 50's)
- Want to make a larger gift
- Limited capital but some discretionary income
- Like paying for gift on installment plan

Ways to Give Life Insurance

Name Charity as Beneficiary but not Owner

- Can be any type of policy, individual or group (term)
  - Charity named as primary beneficiary
  - Charity named as co-beneficiary
  - Charity named as contingent beneficiary
- **Charitable deduction --0--**
- **Potential future proceeds, if... $100,000**
- **Estate tax deduction for proceeds paid to charity**

Name Charity as Beneficiary

Prospects

- Primary Beneficiary: Donors with no heirs or have otherwise provided for heirs; want to retain control (access to cash value or if family circumstances change)
- Co- Beneficiary: Need to retain some value for family
- Contingent Beneficiary: Need to retain value for family but willing to make gift if the worst happens

Ways to Give Life Insurance

Charitable Giving Rider

- 1-2% of face value
- Usually free of charge
- Require large policy – death benefit of $1M+

Give Policy Dividends

- Donor receives dividends and gives them to charity
- Support charity without increasing cash outlay

Name Charity as Beneficiary of Commercial Annuity

- Deferred variable annuity – named beneficiary receives cash value at death
- Immediate payment annuity or the annuitization of a deferred variable annuity - often will have a minimum guarantee period
- Tax-wise way to give; proceeds subject to income tax if given to individual heirs

III. Practical Questions for Consideration

Question A

What are the key questions to ask when offered a gift of life insurance? It Depends!

- Type of Gift
- Type of Policy
- If Term,
  - ✓ Amount of death benefit
  - ✓ Length of term
  - ✓ Amount of the premiums
  - ✓ Who will pay the premiums
  - ✓ Insured's age and general state of health

Question A (continued)

- If Permanent,
  - ✓ Length of time of ownership
  - ✓ Age and general health of donor
  - ✓ Insured's age and general state of health
  - ✓ Paid-up or premiums required
    - Amount of the premiums
    - Who will pay the premiums
    - Financial analysis (policy illustrations)
- Request copy of policy
- Consult an insurance expert

Question B

Why is it necessary to have a life insurance policy appraised when the replacement value or interpolated terminal reserve value can be obtained from the insurance company?

- Independent appraisal required if charitable deduction claimed will exceed $5,000.
  - ✓ Non-cash gift
  - ✓ PPA of 2006 excludes parties related to the transaction
- Donor must file Form 8283.
- Charity must file Form 8282 in case of disposition within three years.

Question C

If premiums are still owing, is it better for the donor to make premium payments directly to the insurance company, or to make contributions to the charity to cover the payments?

Advantages of contributions to charity:

1. Donor can contribute appreciated securities.
2. Larger deduction limit.
3. Charity can better monitor premium payments.

Disadvantages: More administrative responsibility; donor may be less diligent in their gifts to charity than in making payments to insurance company

Question D

What are the consequences if a policy subject to a loan is contributed to a charity?

Cash value	$20,000
Adjusted cost basis	15,000
Loan	6,000
Cost basis allocated to loan [($6,000/$20,000) x $15,000]	4,500
Gain allocated to loan (Donor taxed on this)	1,500
Cost basis allocated to gift – **charitable deduction** [$14,000/$20,000) x $15,000]	10,500

Question E

Should a charity accept gifts of life insurance, and, if so, what acceptance guidelines should apply?

Possible guidelines regarding:

- Policy size
- Age of insured
- Exercise of all rights of ownership
- Payment of premiums

Question F

Should a charity encourage gifts of life insurance?

Case-by-case

vs.

Mass marketing

Question F (continued)

Advantages of a campaign promoting life insurance gifts

- Potential for significant future revenue
- More donors can become major donors
- Simple application process
- Possibly some immediate cash distributions

Question F (continued)

Disadvantages of a campaign promoting life insurance gifts

- May negatively impact annual fund
- Younger donors – longer deferral period
- Time required to track owner/insureds over a long period and monitor premium payments
- High lapse rate
- Possibly higher premium cost because no medical screening
- Political issue of working with one company or agent

Question G

How should life insurance gifts be credited?

Type of Gift	Current Value	Future Value	Amount Credited for Current Giving Club	Qualifies for Legacy Society
Ownership of long existing policy	$15,000	$100,000	$15,000 (if cashed in)	Yes (if not cashed in)
Ownership of new policy	---0---	100,000	---0--- (in future, premium Contributions)	Yes
Beneficiary designation	---0---	100,000	---0---	Yes
Outright gift	100,000	100,000 plus earnings	100,000	No

Question G (continued)

Counting life insurance gifts in a capital campaign

In the case of:

1. A single goal that encompasses both current and deferred gifts,
2. Two goals, one for current gifts and one for deferred gifts, or
3. Three goals, one for current gifts, one for irrevocable deferred gifts, and one for revocable deferred gifts.

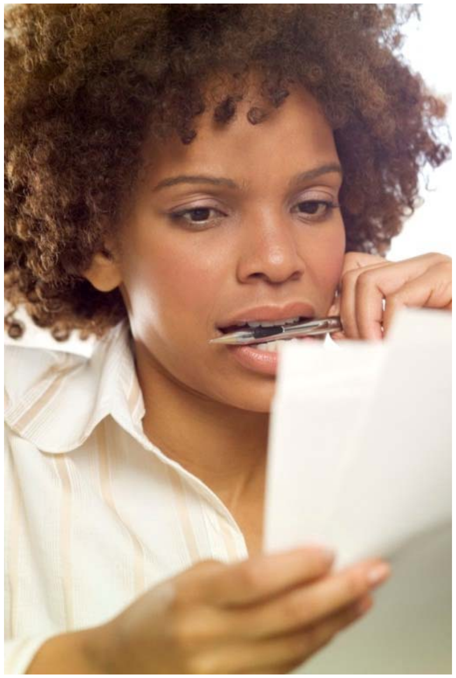
Question H

What should a charity do if a person donates a policy and then stops paying premiums or making contributions to cover them?

- Continue paying premiums with its general funds?
- Surrender the policy for cash?
- Elect a reduced paid-up policy?
- Sell the policy?
- Other?

Question I

Should a charity conduct a periodic review of its life insurance policies?



Question J

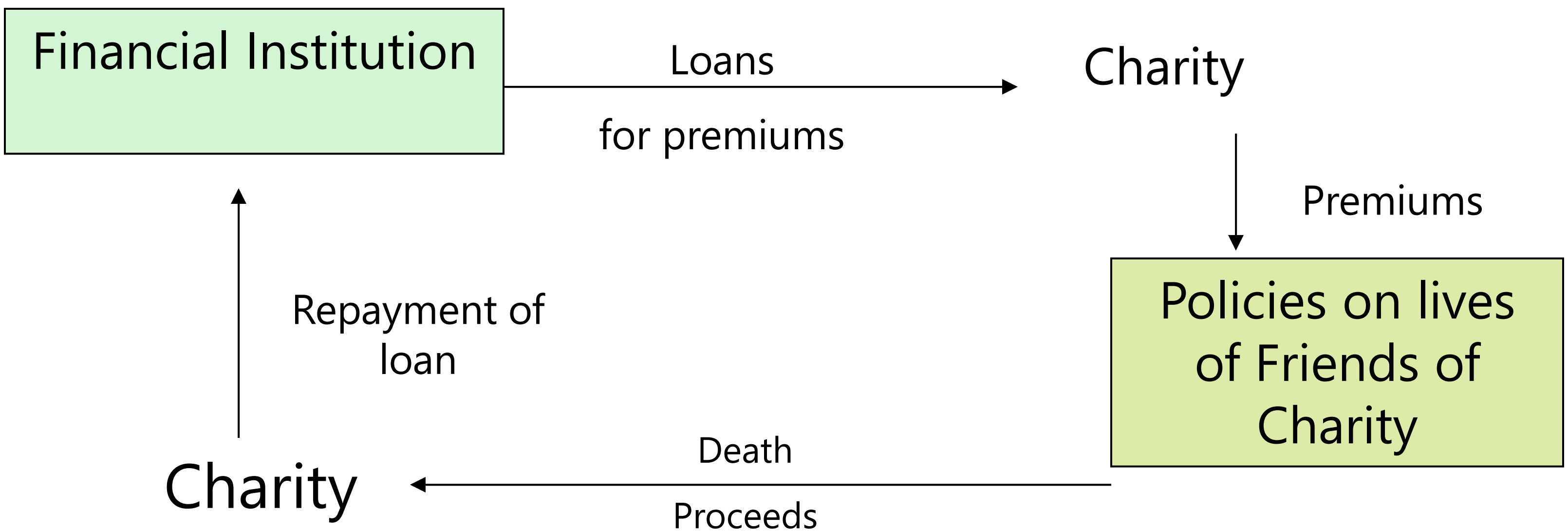
Should a charity commit to establishing a named endowed fund with the proceeds paid on an insurance policy?

Problem: The proceeds received may be well below the minimum for an endowment at that time.

Possible solution: Require that discounted present value of death proceeds equal or exceed current endowment minimum.

Question K (1)

Should a charity participate in a premium-financed life insurance plan?



Charity has excess of proceeds over repayments for its mission.

Question K (1) (continued)

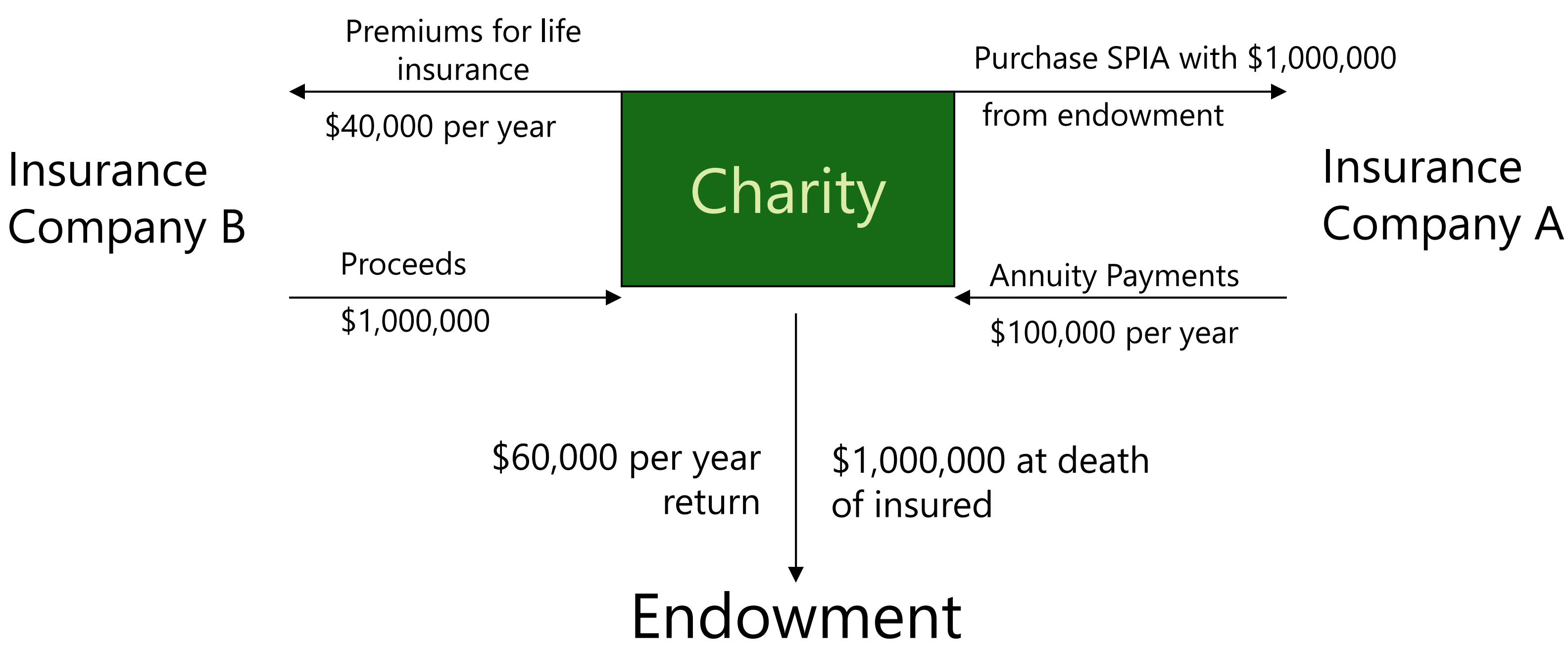
- Legal Questions
- Economic Questions
- Donor Considerations

Google: Oklahoma State University and T. Boone Pickens

Question K (2)

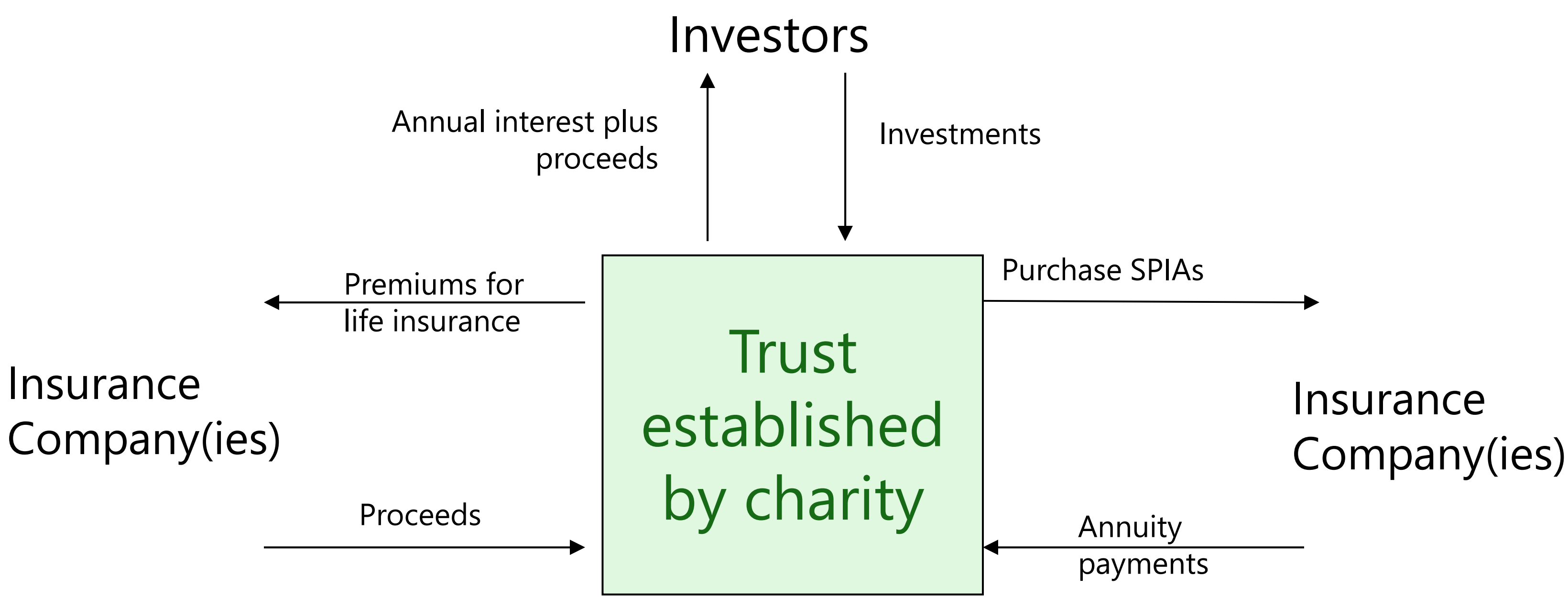
Should a charity participate in an arbitrage arrangement?

Variation 1



Question K (2) (continued)

Variation 2



Charity receives difference between receipts from insurance companies and payments to investors

Question K (2) (continued)

- Insurable interest rules
- Who really benefits?
- Possible UBIT (debt-financed investments)
- Under attack in Congress
- Perception of the charity by donors

Question L

Can a life insurance policy be contributed for a gift annuity?

Example

Donor age	74
Face value of policy	$100,000
Cash value	$40,000
Adjusted cost basis	$22,000

Question L (continued)

	Transfers Policy*	Surrenders Policy, Contributes Proceeds*
Income tax deduction	$9,777	$17,776
Taxation of payments during LE:		
Ordinary income	$1,307 **	$544
Tax-free	$933	$1,696
Taxable ordinary gain in year of gift	-0-	$18,000

* *Assumed gift date of March 15, 2020 and February CMFR of 2.2 percent*

** *Includes taxable gain reported ratably*

Question M

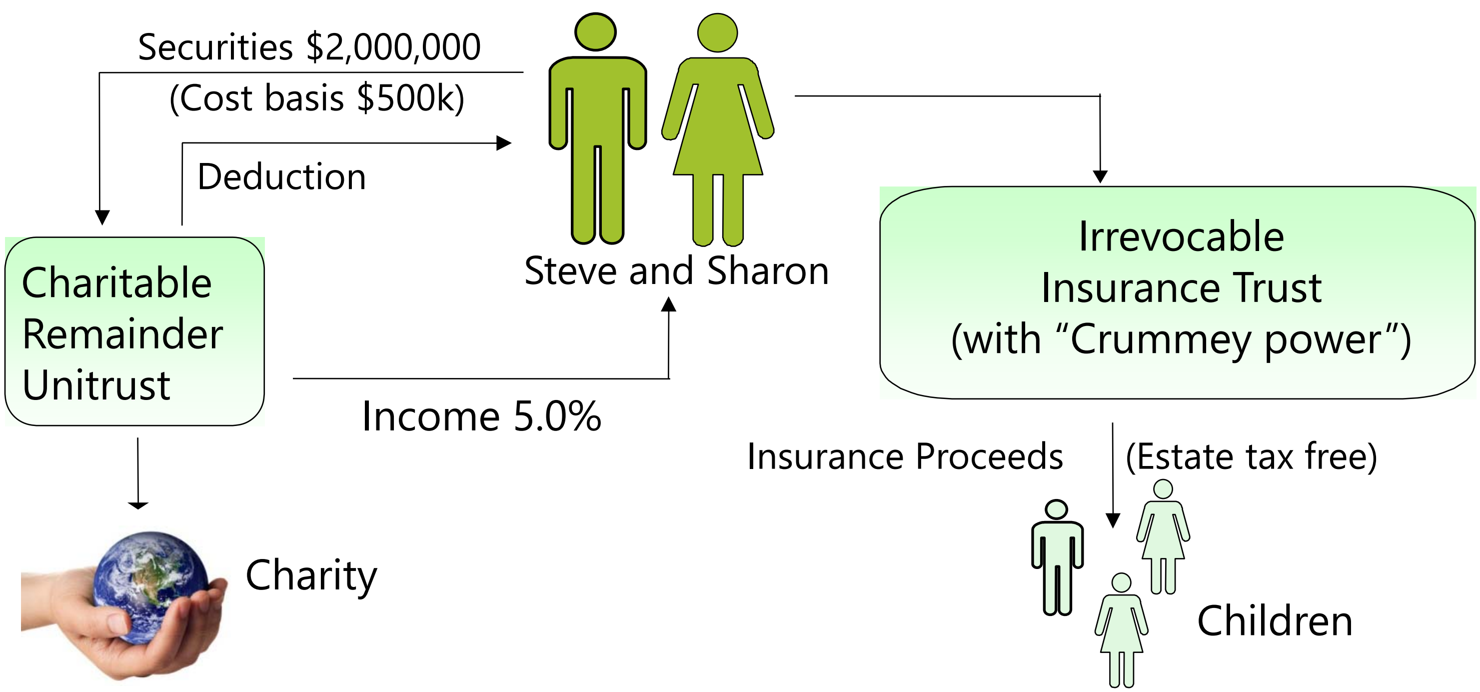
Are the tax consequences of transferring ownership of a commercial deferred variable annuity and transferring ownership of a life insurance policy the same? No.

Example: commercial deferred variable annuity policy which was purchased for $25,000, now has cash value of $60,000.

Cash surrender value	$60,000
Adjusted cost basis	$25,000
Gain taxed as ordinary income	$35,000
Charitable deduction	$60,000
Deduction remaining after offsetting gain	$25,000
Tax savings (35% rate)	$8,250
Value to the charity	$60,000

Question N

What is wealth-replacement life insurance, and should a charity ever suggest it to a donor?



Conclusions

- Include life insurance on the menu of gift options
- Periodically review policies owned by the charity and decide on appropriate action
- Develop crediting policies regarding life insurance
- Become familiar with the tax implications of life insurance gifts and procedures for completing them.

Questions?

Still Have a Question?

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