ECHELON
VIRTUAL FAMILY OFFICE
WEALTH STRATEGIES
ASSET PROTECTION

SHOULD YOU DONATE LIFE INSURANCE TO CHARITY?

KEY TAKEAWAYS

- A charity can be the beneficiary of a life insurance policy, or can be named the outright owner.
- Permanent life insurance is the type most often used for charitable donations.
- Philanthropy—not tax deductions—should be the key driver here.

People purchase life insurance for lots of reasons—the most common often being to take care of their loved ones. The life insurance proceeds are used either to create an estate for those left behind, or to pay taxes so the family receives the estate. Still others might use life insurance to maximize income (such as by supercharging a retirement plan) or to address business concerns (as in the form of providing company benefits).

But did you know you can potentially use life insurance to leave a charitable legacy?

It's true. Life insurance can be an effective way to help the causes you care about by providing the payout from a policy to a charitable organization. Typically, the life insurance death benefit will significantly exceed the premiums paid for the life insurance policy—thus allowing you to make a much larger gift than might otherwise be possible.

Here's a look at how it works.

AN OVERVIEW

The use of life insurance to fund a charitable organization might appeal to you if, for example, you find that you don't have beneficiaries who are in need of the money from the policy.

The biggest advantage of donating a life insurance policy is probably leverage; it is a way to increase the size of a charitable gift. In many cases, it is also a way for donors to receive a greater tax deduction than they'd receive donating cash.

Both term and permanent life insurance policies can be donated to charity. However, permanent insurance is typically used for donations because it's not in force for only a certain number of years (as is the case with term life). This way, the gift will eventually be made even if the donors live very long lives. Another advantage of using a permanent life insurance policy: The charitable organization can surrender the policy for cash if it owns the policy before the donor dies.

THE OPTIONS

There are a number of ways you can donate a life insurance policy to charity. These different approaches have different tax implications for you as the donor (see Exhibit 1). Therefore, it's usually a good idea to seek the advice of a tax professional when making donations of life insurance policies.

EXHIBIT 1

THREE WAYS TO DONATE LIFE INSURANCE TO CHARITY

Donating life insurance to charity

- The charity is named the beneficiary of a life insurance policy
- The charity owns life insurance policy
- The donor gifts the dividends of a life insurance policy

OPTION #1: THE CHARITY IS NAMED THE BENEFICIARY OF A LIFE INSURANCE POLICY

When you name the charity as the beneficiary, the charity gets the death benefit when you (as the donor) die. This is not an all-or-none scenario, though. You can name multiple beneficiaries, such as a number of loved ones and one or more charitable organizations. You name the charity a beneficiary by purchasing a new life insurance policy or adding the charity as a beneficiary on an existing policy.

Important: In many situations, with an existing life insurance policy, it is fairly easy to change or add beneficiaries. However, some life insurance companies can limit the option of making a charity a beneficiary.

The advantages and disadvantages of this approach are shown in Exhibit 2.

EXHIBIT 2

THE CHARITY IS NAMED THE BENEFICIARY OF A LIFE INSURANCE POLICY

	ADVANTAGES	DISADVANTAGES
DONOR	The donor owns the policy and can access the cash account.	The donor must continue to pay the premiums, and there are no tax deductions.
CHARITY	The charity receives a lump sum payment on the death of the insured.	The donor can change the beneficiaries at any time.

OPTION #2: THE CHARITY OWNS THE LIFE INSURANCE POLICY

Alternatively, you (as the donor) can make the charity the owner of a life insurance policy—a strategy that can generate tax deductions for you. This move also gets the insurance policy out of your estate for tax purposes. The downside: Once the charity owns the policy, you're no longer in control of it—and the decision is an irrevocable one.

This can be done with a new policy or an existing one. In both cases, the charity is named the beneficiary and receives the death benefit when the insured dies.

In the case of a permanent life insurance policy, a charity that owns the policy might not have to wait until the death of the insured to receive money. Instead, the charity can potentially use the money accumulating in the policy. Also, if there are funds in the cash account, there is the possibility of surrendering the life insurance policy for the cash value.

The advantages and disadvantages of this approach are shown in Exhibit 3.

EXHIBIT 3

THE CHARITY OWNS THE LIFE INSURANCE POLICY

	ADVANTAGES	DISADVANTAGES
DONOR	The donor takes a tax deduction for the charitable contribution, and if the donor continues to pay the premiums, these payments are also deductible; the life insurance policy is no longer in the donor's estate.	The charity now owns the life insurance policy, and the donor is no longer in control, as the decision is irrevocable.
CHARITY	Owning the policy gives the charity the right to name itself the beneficiary and use the cash account.	The charity might have to take over the premium payments.

OPTION #3: THE DONOR GIFTS THE DIVIDENDS OF A LIFE INSURANCE POLICY

With permanent life insurance policies that provide dividends, you as the donor could use dividends that have built up in the policy to make charitable donations. These contributions are tax deductible. You, as owner, control the life insurance policy, and the charity is not a beneficiary.

The advantages and disadvantages of this approach are shown in Exhibit 4.

EXHIBIT 4

THE CHARITY IS NAMED THE BENEFICIARY OF A LIFE INSURANCE POLICY

	ADVANTAGES	DISADVANTAGES
DONOR	The donor takes tax deductions for donating life insurance dividends while maintaining ownership.	If the dividend pool is tied to the death benefit, it might lower the death benefit.
CHARITY	The charity receives cash without any waiting.	Dividend payments can vary.

When making any gifts to charity—especially gifts that involve financial products and legal structures—it can be wise to consult with a tax or wealth management professional. This will better enable you to understand your options and help ensure you are making a decision that is right for you and your particular situation.

That said, don't automatically let tax considerations be the determining factors in giving to charity. The prime motivation for philanthropy should always be to do good. Keep in mind that even with the tax benefits, you are still giving away some of your wealth. The idea is ultimately to support worthwhile causes in the most tax-effective way possible.

So don't overlook this option. In the end, you might discover that life insurance is a great way to leave a charitable legacy and benefit financially.

ADOPT BEST PRACTICES

By and large, the self-made Super Rich have proven that they know what to do—and what not to do—in oder to create, grow and maintain sizable wealth. By avoiding major slipups on your own path to wealth creation, you can potentially encounter fewer financial potholes along the way.

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