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Enhancing Charitable Giving with Life Insurance

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As the new year comes into view, it is common for individuals and families to consider what charitable gifts to make before the end of the calendar year. However, as with last year, this has hardly been a typical year. Despite the first global pandemic since 1918 and serious economic challenges, Americans set a charitable giving record in 2020 by giving $471 billion to charities, according to The Giving USA report; up 5.1% from 2019. Although it is possible that some of this record setting was due to the adjustment in the Coronavirus Aid, Relief, and Economic Security (CARES) Act[1] from a 50% Adjusted Gross Income (AGI) limitation for charitable contributions by individuals to 100% of AGI for 2020, the Covid-19 pandemic clearly caused many to reflect on what was most important in their lives. Given the charitable giving record, this period may prove to be a lifestyle, economic, and giving inflection point. As such, this article describes four ways to consider utilizing life insurance and annuities to enhance charitable giving.

DONATE AN EXISTING POLICY TO CHARITY

Life insurance policies that were once a cornerstone of a family's financial security plan but are no longer an important component can be an attractive asset to donate to charity. Families may know they have a policy, but often not much more than that as the coverage may have been acquired long ago and may not have been reviewed since. A simple audit, or policy review, will allow a family to determine the dynamics around the policy and its value for charitable giving purposes. Clarity around the policy's owner and beneficiary, cost basis, cash value, and the continued payment of premiums (or not) are initial factors to be considered. The charitable tax deduction when a policy is donated to charity is the lesser of the cost basis and cash surrender value, as provided by the insurance company (e.g., a guaranteed insurance policy with cash value of $600,000, a cost basis of $500,000,

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[1] Pub. L. No. 116-136.

and an insurance benefit of $4 million would allow for a tax deduction of $500,000).[2]

Assuming the insurance coverage is no longer critical to the family's financial security, a policy that was acquired when a family first started financial planning, for example, at the time of a first home purchase or the arrival of their first child, might be a good candidate for a gift. A policy that was acquired as part of an estate plan that is no longer relevant could also be considered. Regardless of the initial purpose, if the need has changed and the coverage is no longer an important component, gifting the life insurance can be a way to enhance what can be done for charity, as ultimately the insurance benefit paid out at the passing of the insured to the charity should be a multiple of the premiums paid into the contract. This can be an effective way for a family to deliver a meaningful charitable legacy in an efficient manner. Assuming the charitable gift value is within the family's AGI limit, a current period tax deduction is achievable.

ACQUIRE A NEW POLICY OWNED BY THE CHARITY

This planning idea is for individuals who want to make a larger charitable gift than they are currently able to make, to an organization they have been financially generous to over time. In this scenario, the donor first works with their insurance advisor to explore policy designs that meet the desired gift level and budget. They then work with their selected charity (e.g., a religious organization, school, hospital, or community foundation) to share the idea and discuss its execution.

Assuming the charity is accepting of the gift of life insurance, the charity applies for and owns a new policy on the life of the insured (the donor). The donor makes annual gifts to the charity in order to fund annual premium obligations, which may also be deductible. The reason the charity owns the policy and pays the premiums is to avoid the donor having any incidents of ownership. This allows the premium gifts to be deductible (of course, subject to AGI limits and the donor's total tax picture). In order for the insurance company to approve the policy, the insurance advisor helps establish the charity's insurable interest in the life of the donor. Insurable interest may be demonstrated through the history with the organization (length and level of involvement), as well as the giving history. Both a track record of financial support and involvement are important.

This type of planning provides flexibility to the donor. For example, for the same amount of coverage, lower premiums can be paid for the remainder of the donor's lifetime or higher premiums can be paid for a limited number of years depending on the donor's budget and preference. Again, those cash gifts may be deductible subject to the total tax picture. This is a way to leverage dollars, as the ultimate payout of the insurance benefit should be greater than the gifts (premiums) made. As an example, a donor would like to make a $1 million gift to her alma mater. The life insurance premium is roughly $10,000 per year, payable for the remainder of her lifetime, and the university has an insurable interest in this long-time contributor and Board member. The school applies for the policy and becomes the owner and beneficiary. The donor donates the annual premium gifts to the school which then remits the premium to the insurance company. The donor does run the risk the school could surrender the policy and use the policy cash value for immediate needs. The school also runs the risk the donor could cease making the premium gifts. The best way to mitigate these two risks is to buy a policy with a single premium, and a guaranteed insurance benefit, which inherently has minimal cash value. This allows the charity to be certain they will receive the ultimate benefit and the donor to know the charity won't surrender the policy.

Although few charities actively promote this kind of planning, many have an alumni or membership base that has made gifts of life insurance policies a significant part of their overall work with donors. As a result, policies are maturing with regularity, creating a steady cash flow for the charity. These gifts of life insurance can help reduce immediate fundraising pressure on the charities by creating longer term influxes of cash to bolster the financial security of the organization.

USE OF ANNUITIES IN CHARITABLE PLANNING

The annuity marketplace in the United States is more than $2.5 trillion because annuities are efficient for income generation, and they are often utilized as a mechanism to self-fund one's retirement. However, annuities are not an ideal tool for wealth transfer planning as proceeds from an annuity at the passing of the owner are treated as income in respect of a decedent, or IRD. As a result, many families balance the retirement benefits of annuities with their charitable planning by utilizing accumulated annuity values, that are not depleted during the lifetime of the annuitant, to fund a charitable bequest at the passing of the annuitant. While it is most common for this strategy to be employed by someone who already owns a funded an-

[2] §170(b)(1)(A), §170(e)(1)(B). All section references herein are to the Internal Revenue Code of 1986, as amended (the ''Code''), or the Treasury regulations promulgated thereunder, unless otherwise indicated.

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nuity, it can also be implemented by someone thinking about their long term income tax planning and charitable giving strategy.

Considering annuities as a component part of one's income tax planning and charitable giving is appropriate when the donor is not ready to part with the assets permanently through a current gift, but is inclined to leave the money to charity at their passing. By relocating investments into an annuity, where the money grows tax-deferred, the capital can grow more efficiently and accumulate to a greater value than similar investments exposed to taxes, which ultimately creates a larger gift to a charity (or multiple charities) of one's choosing. A donor can choose a qualified public charity or a private foundation. This strategy is particularly impactful when the annuity values are invested in heavily taxed assets since the dollars that would have otherwise been lost to taxes now inure to the donor's preferred charities or private foundation.

The donor remains in control of the annuity during their lifetime so they can access the capital if needed, and for this reason they do not receive a current income tax deduction. At death, if a private foundation or qualified charity is designated as the beneficiary of the annuity, deferred gains become fully exempt from income tax and the annuity will not be subject to estate taxes. Annuities have had a reputation for being expensive, but there are attractive options in the marketplace today that are low cost and offer a variety of investment asset classes and funds to choose from. The underlying investments can be reallocated when desired without recognizing tax, thus creating a tax-efficient means of ultimately giving assets away without losing control during one's lifetime.

TARGET A SPECIFIC INHERITANCE FOR HEIRS, REMAINDER TO CHARITY

Warren Buffett is noted for saying, "The perfect inheritance is enough money so that (children) feel they can do anything, but not so much that they could do nothing."[3] Although this quote is elegant and sounds simple in theory, Americans struggle with what "enough money" really means. Balancing lifestyle needs with not spoiling their heirs, and not paying too much in estate taxes, along with making a charitable impact, is not easy and it is often a real quandary for families.

One idea is to acquire a specific amount of life insurance (the amount deemed "enough" for heirs) with the owner and beneficiary as a trust for the benefit of their heirs, and then leaving the remainder of the estate to charity. This strategy can create a specific, predetermined inheritance for heirs, with the amount set from day one. Using lifetime exemption gifts and/or annual exclusion gifts to pay for the life insurance that is owned in trust can often create a satisfactory inheritance (in the eyes of the donor) for the children, while allowing the donor to enhance their charitable impact by avoiding estate taxes on the remainder of the estate which is left to charity.

There are many types of life insurance products to choose from to create a specific inheritance for heirs, including both single life and joint life products, as well as products that hedge against inflation overtime. The myriad of policy options often allows for an economic analysis that engages the grantor and drives planning decisions.

CONCLUSION

Living through a global pandemic has increased the introspection of many Americans and enhanced the desire to contribute to those in need. Now is an ideal time for advisors to help clients explore ways to enhance the financial impact they make on their families and communities. These four ideas of how life insurance and annuities can enhance charitable giving are straightforward and offer the ability to create a meaningful gift that will excite both the giver and receiver.

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[3] Richard I. Kirkland Jr., *Should You leave It All to the Children?,* FORTUNE Magazine (Sept. 29, 1986), http://archive.fortune.com/magazines/fortune/fortune_archive/1986/09/29/68098/index.htm.

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