# Gifts of Life Insurance

Franciscan HEALTH FOUNDATION

## A Low-Cost Gift Opportunity

Life insurance provides a unique opportunity to make a major gift at a modest after-tax cost with no immediate out-of-pocket expense. By assigning ownership of a life insurance policy to a charity, you qualify for an income tax charitable deduction equal to the policy's replacement value or basis in the policy, whichever is less.

## How a Life Insurance Gift Works

To make a gift of life insurance, you simply transfer a policy to us and file an absolute assignment-of-ownership form with the insurance company. The insurance company will send us an endorsement showing that we are the sole owner and beneficiary of the policy.

> **EXAMPLE**: Bob owns a $100,000 life insurance policy with a cash value of $12,000. He can ensure that we receive $100,000 at his death by assigning the policy to us and making annual gifts to us equal to the annual premium payment. Bob can deduct the replacement value of the policy for income tax purposes (or his basis in the policy, if that amount is less). He can also deduct the annual gifts he makes to pay the remaining premiums.

## Other Ways to Give

There are other arrangements you may want to consider when making a gift of life insurance:

- **Name us as the beneficiary of a policy.** Or, make a family member the primary beneficiary and name us the contingent beneficiary, so we would only receive the proceeds if the family member is not living when you die.
- **Buy a new policy and transfer ownership to us.** This method would require you to make annual gifts to us to pay the premiums. These annual gifts are, of course, tax deductible.
- **Donate a paid-up policy.** In many cases, the after-tax cost of this generous gift is only a fraction of the benefit provided to our institution.
- **Transfer a policy to a charitable remainder trust.** This giving option provides many tax and financial rewards. The trust will pay an income for life to your beneficiaries. At the death of the trust beneficiary, all remaining proceeds pass to us. A charitable remainder trust lets you deduct the present value of our remainder interest as a charitable contribution.

# Replacing Donated Assets

Some supporters who want to make a major gift are deterred by the fear that a charitable gift will deprive family members of assets they may need in the future. This presents a classic dilemma where family needs compete with charitable objectives.

Fortunately, the "wealth replacement" (or "capital replacement") technique can solve this problem. It can help you achieve both objectives while minimizing income and estate taxes—and in some cases, capital gains taxes. Wealth replacement works by combining:

- A charitable remainder trust
- A life insurance policy, and
- An irrevocable life insurance trust.

### The Wealth Replacement Arrangement

- You transfer long-term appreciated property to a charitable remainder unitrust (CRUT) and qualify for a federal income tax deduction for the present value of the charity's remainder interest, subject to limitations.
- The CRUT pays you an income for life, or for a term of years not to exceed 20.
- The trustee of the CRUT can sell an asset without paying capital gains tax.
- You use the income from the CRUT to make gifts to an irrevocable life insurance trust (ILIT). The ILIT trustee can use the gifts (after the beneficiary's right of withdrawal has expired) to pay premiums for a life insurance policy on your life owned by the ILIT. The initial face amount of the policy is often the fair market value of the property you transferred to the trust.
- When you die, the ILIT receives the policy proceeds and distributes them to the trust beneficiaries, and the charity receives the remaining CRUT property.

**RESULT**: You qualify for a current income tax charitable deduction and increased cash flow for life. You make a significant gift to charity, and your heirs are "made whole" with life insurance that replaces the donated capital.

## Wealth Replacement Case Study

**The Dilemma.** Mary owns marketable securities worth $500,000. She purchased the securities many years ago for $100,000, and they are producing income of around $12,500 each year (a 2.5% return). Mary considers selling the securities and reinvesting the proceeds to obtain a higher income, but she is not happy about the capital gains tax that she would have to pay as a result of the sale. Ultimately, Mary would like to split the securities (or the sale proceeds) in her will among her three grandchildren. Mary is also one of our ardent supporters who is committed to making a significant gift to us, but not at the expense of her grandchildren.

**A Logical Solution.** With the assistance of her advisors, Mary transfers the securities to a charitable remainder unitrust (CRUT) that will pay her an annual income of 5% of the value of the trust assets as re-valued every year. Payments continue for as long as she lives, with the remainder going to us at Mary's death. Mary is eligible to take a charitable tax deduction for the present value of our remainder interest in the trust (assuming she itemizes), and she will also avoid any capital gains tax on the transfer to the trust.

Second, Mary creates an irrevocable life insurance trust (ILIT) and the trustee purchases a life insurance policy on Mary's life in the amount of $500,000 (or more) to replace the value of the securities she donated in the CRUT. She makes annual gifts to the ILIT to pay the premiums on the policy using the savings generated by the charitable income tax deduction and her income from the charitable remainder unitrust. As grantor of the ILIT, Mary names her grandchildren as equal beneficiaries of the trust.

When Mary dies, the charitable remainder trust will pass all remaining assets to us, and the irrevocable life insurance trust will distribute the insurance proceeds to the grandchildren (or hold and invest the proceeds for their benefit).

**Consider the Benefits.** This technique helped Mary effectively accomplish both her goals by enabling her to:

- Fulfill her long-held desire to make a substantial gift to us.
- Preserve the size of the gift passing to her grandchildren.
- Avoid an immediate capital gains tax liability by transferring the appreciated securities to a charitable remainder unitrust.
- Enjoy an income tax charitable deduction in the year she transfers the securities to the charitable remainder unitrust.

- Remove the transferred securities and the life insurance proceeds from her gross estate for tax purposes, potentially saving her heirs thousands of dollars.
- Pass the insurance proceeds to her grandchildren income tax free.
- Make two major gifts with the same asset—one to her grandchildren and one to us!

## A Final Word

As you can see, the wealth replacement technique is not as complicated as it might have appeared at first. If you would like to explore a satisfying and tax-rewarding gift of life insurance or develop a plan for wealth replacement, we are happy to help. It would be our privilege to provide additional information or to answer any questions or concerns you or your financial advisors may have.

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