

Charitable gifts of life insurance

In brief

WHY LIFE INSURANCE?

Leverage

The greatest advantage of a gift of life insurance is that a donor can make a substantially larger gift to charity by using life insurance than by giving any other asset. Relatively modest annual premiums mature into a substantial death benefit at the donor's death. This is further enhanced when a charity owns the policy because of the income tax charitable deduction the donor receives. The donor's gift (cash to pay premiums) essentially costs less. For example, for a donor in a 30% tax bracket, a gift of \$2,500 really costs \$1,750 after factoring in the income tax charitable deduction.

Gift of an existing policy

The gift of an existing policy can be relatively painless to the donor in several respects. The transfer is simple; all that is required to complete the transfer is a change of ownership form. Absent a loan on the policy, the donor does not recognize income no matter how large the gain. In addition, if the donor does not intend to use the policy as a source of cash, a gift of a policy is not often perceived as a loss of an asset.

Benefit to charity

A charity-owned life insurance policy requires less administration by the charity than many other assets, like real estate or business interests. In addition, the charity can easily take advantage of accumulated values in the policy before the donor's death by using loans or withdrawals. Both the accumulated value buildup and the death benefit are generally income tax-free to the charity.

Death benefit

The death benefit, whether from a policy owned by the charity or from a policy with the charity named as beneficiary, is received by the charity without reduction for estate or income taxes and is not subject to the delays and expenses of probate. The death benefit is less likely to be contested by the donor's beneficiaries than other assets.

CHARITABLE GIFTS OF LIFE INSURANCE

Name charity as beneficiary of policy

- No income tax charitable deduction.
- At death, the death benefit may be included in the estate for estate tax purposes; if so, the estate receives an offsetting estate tax charitable deduction.

(REV 0821)

Name charity as irrevocable beneficiary of policy

- No income tax charitable deduction.
- At death, the death benefit may be included in the estate for estate tax purposes; if so, the estate receives an offsetting estate tax charitable deduction.

Transfer policy to charity

- Income tax charitable deduction in year of gift.
- The death benefit is not included in the insured's estate for estate tax purposes if the gift is more than three years before death. If death occurs within three years of the gift; the death benefit may be included in the estate for estate tax purposes; if so, the estate receives an offsetting estate tax charitable deduction.
- Change of ownership and beneficiary designation forms should be completed showing the charity as owner and beneficiary.

Transfer cash to charity to purchase a new policy

- Income tax charitable deduction in year of gift.
- The death benefit is not included in insured's estate.
- Charity must have insurable interest in the donor.
- In states where charity has insurable interest in a donor, charity should be applicant, owner, and beneficiary.
- In states where charity lacks an insurable interest in a donor, donor should be the applicant and charity should be the owner and beneficiary.

Pay premiums on policy owned by charity

- Income tax charitable deduction in year of gift.

INCOME TAX CHARITABLE DEDUCTION

Congress encourages charitable contributions by providing income tax deductions for gifts to charity. To take advantage of these deductions, a donor must meet certain requirements and is subject to certain limits. Review Appendix A – Income Tax Charitable Deduction Chart for more details.

Amount deductible

- If giving an existing policy, the amount deductible is the lesser of the donor's basis in the policy or the policy value.
- If giving cash, the amount of cash given is the amount deductible.

Adjusted gross income (AGI) limit

- If the gift is cash to a public charity, the deduction is limited to 60% (100% for 2020 and 2021) of the donor's AGI for the year of the donation. If the gift to a public charity is an asset, the deduction is limited to 50% of the donor's AGI. Public charities are generally organizations that receive their funding from government and the general public. Some examples of public charities are schools, churches, hospitals, charities for disease prevention or cure, and charities that benefit the community.

- If the gift is to a private foundation, the deduction is limited to 30% of the donor's AGI for the year of the donation. Private foundations are generally organizations that receive their funding from a small number of donors, often members of the same family.
- See **Appendix A – Income Tax Charitable Deduction Chart** for a full review of the deduction limits and how they work with different types of property.

Carry forward

- Deductible amounts not used in the current year because they exceed AGI limits may be carried forward for the next five years.

Substantiation requirements

- The donor must obtain a contemporaneous written acknowledgment from the charity for any contribution (cash or non-cash) of \$250 or more. An acknowledgment is not required if the charity reports the contribution to the IRS.
- For non-cash gifts, if the amount of the charitable deduction claimed is more than \$5,000, the donor must also obtain a qualified appraisal.

EXAMPLE – CHARITY AS BENEFICIARY OR AS OWNER

Donor wishes to benefit his favorite museum. He owns a policy on his life with a basis of \$6,000, an accumulated value of \$35,000 and a death benefit of \$100,000. The annual premium for the policy is \$800. Donor wants to receive a current income tax charitable deduction. His AGI for this year is \$50,000.

Naming charity as beneficiary

If Donor names the charity as beneficiary, the charity receives a death benefit of \$100,000 at Donor's death. However, the Donor does not get a current income tax charitable deduction.

Giving policy to charity

Instead, if Donor gives the policy to the charity, Donor receives an income tax charitable deduction this year of \$6,000 which is his basis in the policy. Assuming the museum is a public charity, his deduction is limited to 50% of his AGI - \$25,000. Therefore, the entire \$6,000 is deductible this year. Donor needs to obtain a qualified appraisal or the deduction is denied.

If Donor dies within three years of the gift of the policy, the death benefit is included in his estate. However, the estate receives an estate tax charitable deduction for the same amount.

If Donor continues to pay the premium on the charity-owned life insurance policy, either by sending the payment directly to the insurance company or by giving cash to the charity, he receives an income tax charitable deduction for \$800 each year. To claim this deduction, Donor needs a written acknowledgment from the museum each year unless the charity reports the donation to the IRS. To ensure the museum sends the written acknowledgment, Donor should send the \$800 to the museum and let the museum pay the premium.

GIFT OF POLICY WITH LOAN

Does it make sense?

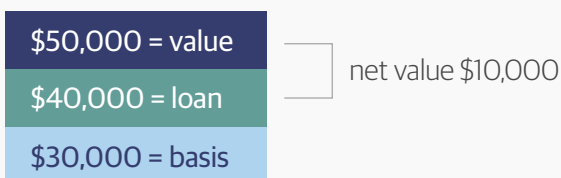
If a policy with a loan is transferred to a charity, the donor is relieved from paying off the loan, which is treated as an amount received by the donor under bargain sale (part-gift / part-sale) rules. Also, because the gift is to a charity, the donor's basis in the policy is allocated in part to the charitable gift and in part to the sale. This generally increases the amount that's income taxed and decreases the charitable deduction. See Treasury Regulation § 1.1011-2(b).

How is basis allocated?

Basis is allocated in the same proportion that the loan has to the total policy value, as follows:

- Basis allocated to sale = basis x (loan amount / total policy value)
- Basis allocated to charitable gift = basis x (net value / total policy value)
- Examples: Donor gives to charity a policy that has a loan against it. It is irrelevant whether the loan is more than or less than basis.

EXAMPLE 1



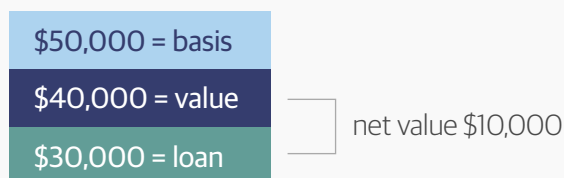
Sale Basis: $30,000 \times (40,000 / 50,000) = 24,000$

Gift Basis: $30,000 \times (10,000 / 50,000) = 6,000$

Donor "receives" \$40,000 (amount of loan he is relieved from paying back) and can allocate \$24,000 of basis to sale, leaving \$16,000 of ordinary income. In this case, the Donor's charitable gift is limited to the charitable gift basis, providing an income tax charitable deduction of \$6,000.

	SALE	GIFT
Amount received	40,000	10,000
Basis	24,000	6,000
Ordinary income (amount received less basis)	16,000	
Charitable deduction (lower of fair market value or basis)		6,000

EXAMPLE 2



Sale Basis: $50,000 \times (30,000 / 40,000) = 37,500$

Gift Basis: $50,000 \times (10,000 / 40,000) = 12,500$

Donor "receives" \$30,000 (amount of loan he is relieved from paying back) and can allocate \$37,500 of basis to sale, leaving no ordinary income. (Loss on the sale or exchange of an asset held for personal use is generally not deductible.) In this case, the Donor's charitable gift is the value of the policy, providing an income tax charitable deduction of \$10,000.

	SALE	GIFT
Amount received	30,000	10,000
Basis	37,500	12,500
Ordinary income (amount received less basis)	0	
Charitable deduction (lower of fair market value or basis)		10,000

APPENDIX A

Income tax charitable deduction chart

	PUBLIC CHARITY	PUBLIC CHARITY	PRIVATE FOUNDATION	PRIVATE FOUNDATION
Type of property	Deductible amount	Deduction limitation as a percentage of AGI	Deductible amount	Deduction limitation as a percentage of AGI
Cash	Fair market value	60% (100% for 2020 & 2021)	Fair market value	30%
Ordinary income property	Cost basis	50%	Cost basis	30%
Short-term capital gain property	Cost basis	50%	Cost basis	30%
Long-term capital gain property	Fair market value	30%	Qualified appreciated stock: Fair market value	20%
Long-term capital gain property			All other LTCCG property: Cost basis	20%

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