

LIFE INSURANCE IN PHILANTHROPIC PLANNING

Fixed life insurance is a financial tool with many philanthropic uses. While its advantages for personal and business planning are well understood, its utility in philanthropic planning is often overlooked. Life insurance can appear to be a complex and intimidating concept when considered as a gift vehicle. However, there are simple and direct uses of life insurance as a gift vehicle that can provide significant benefits to a non-profit organization.

#1 - Gift of a Paid-Up Policy

“Done paying for it and don’t need the coverage anymore? Transfer it to us.”

One of the easiest ways to employ life insurance as a philanthropic gift, this approach allows your donor to give an asset that he or she no longer needs. The donor receives the benefit of a tax-deductible gift and your organization receives a gift ultimately worth significantly more than the donor’s cost basis.

Why?

Cost basis (usually the premiums paid) is generally lower than the ultimate death benefit of a life insurance policy. For example, if a 45 year old male donor in standard health purchased a \$1,000,000 policy guaranteed to stay in force until age 100, a single premium would be approximately \$155,000. Though the non-profit would not receive the policy proceeds until his death, it would ultimately receive a \$1,000,000 gift. No premiums would be required after the policy was transferred to the non-profit. The non-profit organization would experience only the minimal burden of annual updates on the policy until the donor’s death.

#2 - Gift of a Premium-Paying Policy; Non-Profit pays on-going premiums

“You have a life insurance policy that still requires premium payments, but you don’t need the coverage? Transfer the policy to us - We’ll maintain the premiums.”

If your donor has a permanent policy that he or she no longer requires, but has continuing scheduled premiums, it may be beneficial for your organization to consider taking over the policy and its required premiums.

Why?

Rates of return at actuarially determined life expectancies typically hover between 5% - 7%. This return factors in all premiums paid throughout the life of the policy. If several premium payments have already been made by the donor, the rate of return on the premiums paid by the non-profit organization will be higher.

Your donor will receive a charitable income tax deduction equal to the lesser of the cost basis or the fair market value of the gift and your organization will benefit from the potential to receive significantly higher rates of return.

For example:

A male donor with a \$1,000,000 permanent policy issued at age 45 has an annual premium of \$6,410. After paying the required premium for 10, 15 or 20 years, he decides he no longer needs the coverage and would prefer to gift his policy to your organization rather than let it lapse. At his life expectancy, age 80, the internal rate of return on the organization’s investment in the policy ranges between 12.30% and 26.40%, depending upon the year in which the gift was made.

Rates of Return When Premiums Are Taken Over by the Non-Profit

Policy Year	Age	Annual Premium (age 55)		Annual Premium (age 60)		Annual Premium (age 65)	
			IRR		IRR		IRR
1	46		NA		NA		NA
2-9	47-54		NA		NA		NA
10	55		NA		NA		NA
11	56	\$6,410	15500.60%		NA		NA
12	57	\$6,410	1100.00%		NA		NA
13	58	\$6,410	401.20%		NA		NA
14	59	\$6,410	222.90%		NA		NA
15	60	\$6,410	148.20%		NA		NA
16	61	\$6,410	108.50%	\$6,410	15500.60%		NA
17	62	\$6,410	84.40%	\$6,410	1100.00%		NA
18	63	\$6,410	68.30%	\$6,410	401.20%		NA
19	64	\$6,410	56.90%	\$6,410	222.90%		NA
20	65	\$6,410	48.40%	\$6,410	148.20%		NA
21	66	\$6,410	41.90%	\$6,410	108.50%	\$6,410	15500.60%
22	67	\$6,410	36.80%	\$6,410	84.40%	\$6,410	1100.00%
23	68	\$6,410	32.70%	\$6,410	68.30%	\$6,410	401.20%
24	69	\$6,410	29.20%	\$6,410	56.90%	\$6,410	222.90%
25	70	\$6,410	26.40%	\$6,410	48.40%	\$6,410	148.20%
26	71	\$6,410	24.00%	\$6,410	41.90%	\$6,410	108.50%
27	72	\$6,410	21.90%	\$6,410	36.80%	\$6,410	84.40%
28	73	\$6,410	20.10%	\$6,410	32.70%	\$6,410	68.30%
29	74	\$6,410	18.60%	\$6,410	29.20%	\$6,410	56.90%
30	75	\$6,410	17.20%	\$6,410	26.40%	\$6,410	48.40%
31	76	\$6,410	16.00%	\$6,410	24.00%	\$6,410	41.90%
32	77	\$6,410	14.90%	\$6,410	21.90%	\$6,410	36.80%
33	78	\$6,410	13.90%	\$6,410	20.10%	\$6,410	32.70%
34	79	\$6,410	13.10%	\$6,410	18.60%	\$6,410	29.20%
35	80	\$6,410	12.30%	\$6,410	17.20%	\$6,410	26.40%

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#3 - Gift of a Premium-Paying Policy; Donor gifts annual premiums

“You have a life insurance policy that still requires premium payments, but you don’t need the coverage? Transfer the policy to us and help us maintain the policy by making annual tax-deductible gifts to us in the amount of the premium.”

Donors who have permanent life insurance policies that they no longer need but which require ongoing premium payments may be interested in transferring the policy to your organization and maintaining the scheduled premiums.

Why?

Your donor will receive a charitable income tax deduction based on the lesser of the cost basis or the fair market value of the gift and continue to receive tax deductions based on the annual gift equal to the amount of premium paid. The policy will remain in force and your organization will receive the full benefit of the policy without any outlay of premium.

It is important to note that this arrangement requires annual reviews to ensure that the policy is performing as anticipated so that your organization receives the expected gift.

#4 - Gift of a Charitable Insurance Rider

“Did you know that some insurance carriers will give you the opportunity to name a charity for 1% of the policy’s death benefit and there is no cost for the charitable benefit? If you are going to buy an additional \$1,000,000 of coverage with one of these companies, would you consider naming us as your charitable beneficiary for the \$10,000 benefit?”

Many life insurance companies offer their policy owners the option of adding a charitable insurance rider at no extra charge at the time of policy application. The policy owner simply designates the additional death benefit to the non-profit organization as the beneficiary.

Why?

Your donors most likely employ life insurance in their personal and/ or business planning. Insurance companies and the agents and brokers selling the policies do not often bring to their clients' attention the option of adding this charitable insurance rider, yet it is frequently available. While there is no tax benefit for your donor, it does give them the opportunity to contribute to your organization without affecting their financial resources. Informing your donors of this option at least once a year via newsletter or similar means help will ensure that you are remembered when they revisit their personal planning needs.

#5 - Irrevocable Beneficiary as a “Funded Bequest”

“Previously, you expressed some reluctance about naming us as a beneficiary under your will. We discussed at that time your desire to financially help the organization but you did not want to incur the expense or the upset of rewriting your will. Would you consider naming us as an irrevocable beneficiary for all or part of any life insurance policies that insure your life now?”

While an irrevocable beneficiary is not completely guaranteed, it is the best way to ensure you receive the intended part of the life insurance death benefit if your donor is unwilling to make your organization the owner of the policy. Unless the owner stops paying premiums and allows the policy to lapse, your organization will received the stated death benefit.

Why?

Not all donors are interested in transferring rights of an insurance policy on their lives to another owner, even if it is a non-profit organization. Similarly, they are not always interested in re-writing a will. This option may ensure that your organization receives a “funded bequest”. The owner’s intentions to contribute to your organization are preserved. Life insurance proceeds do not pass through probate, so your organization would receive the actual gift more quickly than a testamentary bequest.

#6 - Gift of a Convertible Term Policy; Non-Profit reserves the right to convert and pays premiums

“You have a term insurance policy with a conversion right, but you no longer need the coverage? Would you consider giving us that policy? We may want to exercise the conversion for our benefit.”

Term (temporary) insurance is a popular product because it is inexpensive. Many of your donors have term insurance for limited periods of time to meet specific needs - needs that may cease to exist at some point during the life of the insurance policy. The policy may have a “conversion” option, which allows the policy owner to convert the term policy into a permanent policy, thus ensuring the receipt of the death benefit beyond the original term of the policy.

Why?

While converting a term policy into a premium policy will raise the annual premium, the premiums already paid into the policy will improve the internal rates of return for your organization. Additionally, most conversion options will preserve the original underwriting so that, for example, if your donor was originally a “preferred” risk, but no longer is, the new permanent policy will be issued based on the original risk classification when the policy was issued and the premiums will reflect that.

For example:

A male donor with a \$1,000,000 term policy issued at age 45 has an annual premium of \$1,459. After paying the required premium for 10, 15 or 20 years, he decides he no longer needs the coverage and would prefer to gift his policy to your organization rather than let it lapse. Your organization converts the policy to a permanent policy and pays the corresponding premium based upon the age of the donor at the time the policy was converted.

Rates of Return When A Term Life Policy is Converted and Taken Over by Non-Profit at Various Policy Years

Policy Year	Age	Annual Premium (age 55)		Annual Premium (age 60)		Annual Premium (age 65)	
			IRR		IRR		IRR
1	46		NA		NA		NA
2-9	47-54		NA		NA		NA
10	55		NA		NA		NA
11	56	\$10,771	9184.2%		NA		NA
12	57	\$10,771	814.8%		NA		NA
13	58	\$10,771	315.0%		NA		NA
14	59	\$10,771	179.0%		NA		NA
15	60	\$10,771	120.1%		NA		NA
16	61	\$10,771	88.3%	\$14,902	6610.5%		NA
17	62	\$10,771	68.6%	\$14,902	670.7%		NA
18	63	\$10,771	55.5%	\$14,902	268.1%		NA
19	64	\$10,771	46.1%	\$14,902	154.1%		NA
20	65	\$10,771	39.1%	\$14,902	103.8%		NA
21	66	\$10,771	33.7%	\$14,902	76.3%	\$19,426	5047.7%
22	67	\$10,771	29.4%	\$14,902	59.2%	\$19,426	569.2%
23	68	\$10,771	26.0%	\$14,902	47.7%	\$19,426	233.3%
24	69	\$10,771	23.1%	\$14,902	39.5%	\$19,426	135.2%
25	70	\$10,771	20.8%	\$14,902	33.4%	\$19,426	91.2%
26	71	\$10,771	18.8%	\$14,902	28.6%	\$19,426	66.9%
27	72	\$10,771	17.0%	\$14,902	24.9%	\$19,426	51.8%
28	73	\$10,771	15.6%	\$14,902	21.8%	\$19,426	41.5%
29	74	\$10,771	14.3%	\$14,902	19.3%	\$19,426	34.2%
30	75	\$10,771	13.1%	\$14,902	17.2%	\$19,426	28.7%
31	76	\$10,771	12.1%	\$14,902	15.5%	\$19,426	24.5%
32	77	\$10,771	11.2%	\$14,902	14.0%	\$19,426	21.1%
33	78	\$10,771	10.4%	\$14,902	12.7%	\$19,426	18.4%
34	79	\$10,771	9.7%	\$14,902	11.5%	\$19,426	16.2%
35	80	\$10,771	9.0%	\$14,902	10.5%	\$19,426	14.3%

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#7 - Gift of Cash or Securities - used to buy a single premium immediate annuity; annuity income is used to buy life insurance

“Several years ago, you expressed an interest in endowing a chair named in honor of your mother. The barrier was that you felt a commitment of \$2.5 million was larger than you were comfortable with. With our financial advisors, we have developed the means to fully fund your mother’s endowed chair at the \$2.5 million level using a gift of less than half that amount. At your age, the required gift would be \$1.2 million. Assuming the gift is tax-deductible for Federal, State and City purposes, your net after tax cost (@ 50% combined) may be as low as \$600,000. Would you like to discuss this concept of endowing your mother’s Chair further?”

Principal gifts to create endowed chairs and major projects are not always easy to secure. The high thresholds required may be difficult for many donors to fulfill. Using a single premium immediate annuity in conjunction with life insurance may provide enough leverage to turn a smaller cash gift into an amount large enough to fulfill an endowment obligation. The necessary contribution required of the donor in this arrangement is typically between 33% and 60% of the funds the endowment will ultimately receive.

Why?

Your donor will receive the appropriate recognition for endowing a project or chair, but at a far lesser cost than typically required. This may allow your organization to open endowment discussions with new donors previously thought to be unable to make such a sizable gift. It will also guarantee that your organization receives the funds required to endow the project without the fear that a pledge will go unfulfilled.

How?

- Donor gifts the full purchase price of a single premium immediate annuity (“SPIA”) to non-profit organization (“NPO”)
- NPO purchases the SPIA in straight life form with the donor as the annuitant
- NPO uses the annual SPIA income to purchase a life insurance policy on the donor and fund all future premiums

- NPO is the owner and beneficiary of both the annuity and the life insurance policy
- Upon the death of the donor, NPO receives the entire death benefit of the life insurance policy and directs the money to fulfill the endowment pledge
- Donor receives recognition and credit for the value of the insured endowed benefit

\$2,500,000 Endowments Using Fixed SPIAs and Life Insurance

Sex	Age	Risk	Tax Deductible Gift	Donor Gift Cost	NPO Annuity Purchase Price	Annual SPIA Income to NPO	NPO Annual Life Insurance Program	Insured Endowment Benefit
M	65	Std	\$1,003,000	\$501,500	\$1,003,000	\$76,800	\$75,000	\$2,500,000
M	70	Std	\$1,205,000	\$602,500	\$1,205,000	\$101,910	\$98,600	\$2,500,000
M	75	Std	\$1,400,000	\$700,000	\$1,400,000	\$140,730	\$135,300	\$2,500,000
F	65	Std	\$825,000	\$412,500	\$825,000	\$58,080	\$56,600	\$2,500,000
F	70	Std	\$970,000	\$485,000	\$970,000	\$76,440	\$74,300	\$2,500,000
F	75	Std	\$1,210,000	\$605,000	\$1,210,000	\$110,670	\$106,900	\$2,500,000

#8 - Combining gifts to create future capital funds

“Our Board is considering a plan to restore our capital fund to its pre-2008 level. As one of our most loyal supporters, you know that our fund dropped by nearly 30% in the crash of the financial markets. We’ve recovered somewhat, but we are still down nearly \$50 million. The Board’s plan to replenish the fund involves insuring each Board Member for the benefit of the organization. We are asking you to contribute \$50,000 annually for 10 years together with other loyal supporters to supply the premiums needed for the capital pool.”

Board members are easy to insure for the benefit of a non-profit organization because their value is quantifiable and recognizable, a requirement under state

insurable interest laws. They are generally historical donors and also volunteer their skills, leadership and support to further the organization's mission. If Board members are willing to be insured to benefit the organization, they will be recognized as contributing to the creation of a major gift to support future operations and growth.

Why?

Because of the value of a Board member to its organization, the potential death benefits can be quite large. Insuring multiple older Board members with large death benefits will create new, substantial endowment funds. The premiums do not have to be paid by the insured Board members themselves, rather a supporting "giving society" can be created to recognize donors who are contributing to this fundraising plan. The donors will receive the appropriate tax deductions for the cash contributions as well as the recognition for supporting the plan and the Board members will receive recognition as well.

#9 - Gift of low basis, appreciated securities to a charitable remainder trust ("CRT") in conjunction with a wealth replacement trust funded by life insurance

"Last year we had discussed the possible gift of some of your low basis, appreciated securities. Unfortunately, the market drops removed about a third of their value. I was glad to learn that now that the values have been almost completely restored, you'd like to continue our conversation. We spoke of a trust into which you would transfer irrevocably securities of a certain value. The Trustee would sell the securities, pay no capital gains taxes on the sale, and invest the sale proceeds. You would receive a charitable income tax deduction according to a calculated formula. You would receive annual income from the trust for a predetermined number of years or for life, after which the trust assets would be transferred to us.

One issue that was raised, but not addressed, was your concern that your children might have some reservations about a gift of significant value. Their less than total enthusiasm for the gift is understandable, especially since they are the

beneficiaries of your estate. If we could develop a way for you to replace the value of the gift for the benefit of your children, yet still make the gift, help our organization, and receive annual income would you be interested in continuing our discussions in greater detail?"

A donor's interest in supporting a non-profit organization may sometimes conflict with his or her interest in leaving assets to family. Though tax regulations may affect the overall value of an asset depending upon the recipient, that may not always be the determining factor when deciding to whom gifts and assets should be allocated. Combining a charitable remainder trust with a wealth replacement trust may allow a donor to meet both of his or her important goals - giving to charity and giving to family.

Why?

Low basis, appreciated securities are an ideal asset to transfer to a charitable remainder trust because it can relieve the donor of onerous capital gains taxes. However, the high value of the securities is something that the donor may have depended upon to leave assets to his or her heirs, regardless of estate taxes.

By transferring the highly appreciated securities to a CRT, the donor not only removes the securities from his or her estate and but also is not required to pay capital gains taxes when the CRT sells the securities. The CRT will pay an annual income to the donor and the CRT's remainder interest will be a gift to the non-profit organization.

Had the donor intended to leave the value of the securities to heirs, he/she could then acquire a life insurance policy, to be owned by a trust, and, depending on premium cost and gift tax considerations, give all or some of the premium payments to maintain the policy. At the donor's death, the heirs would receive the death benefit of the life insurance policy held by the trust. In some structures, the income to the donor from the CRT could be applied to the premium payments to further reduce the burden of the cost of insurance.

#10 - Family Philanthropy: Life insurance held by a donor-advised fund

“We’ve given considerable thought to your expressed desire to involve your children and your grandchildren in your philanthropic endeavors. We understand that one of your goals is to build a family shared value of giving and helping others. We believe you have a mechanism now in place, your donor-advised fund, that can incorporate your designated family members in your decision-making process. We also believe we have a plan for significantly increasing the value of your fund to increase its ultimate value to causes of interest to the family. Would you like to meet to discuss our ideas further?”

Older donors often express an interest to involve their children and grandchildren in their charitable planning. Donor-advised funds and family foundations are often appropriate giving vehicles to support this interest, yet their future funding is not always certain.

Why?

Using life insurance in a donor-advised fund ensures that the family giving vehicle will have a large infusion of new capital when it is needed most to perpetuate giving by new generations of family members - at the death of the older donor. Infusing this new principal should help to ensure that there is funding to allow the future generations to participate in philanthropy and to continue supporting the original donor’s charitable interests.

National Madison helps non-profit organizations utilize life insurance in their major and planned giving campaigns. If you require assistance with life insurance policies currently in your possession or with the acquisition of new life insurance gifts, please contact us.