



Frequent Questions about Life Insurance as a Charitable Giving Tool

You asked for it. In response to your queries, we present this series of questions and answers focused on the use of life insurance as a charitable planning tool.

Q. When I give existing life insurance policies to charity, how much will my charitable income tax deduction be?

A. Your deduction is generally equal to the lesser of the fair market value of the policy or the amount paid for the policy (cost basis). Of course, this amount is subject to the general deduction limitations placed on charitable contributions.

More specifically, where a policy does not contractually require additional premiums to remain in force at the time of the gift, the charitable deduction is the lesser of the policy replacement cost or your cost basis.

If the policy requires additional premiums at the time of the gift, the charitable deduction is the lesser of the policy's adjusted interpolated terminal reserve value (which is generally fairly close to the policy's cash surrender value) or your cost basis in the policy.

Q. What are the "general limitations" that apply to charitable contributions?

A. In general, taxpayers may take charitable deductions up to 50% of their annual adjusted gross income, but 30% or 20% limitations may apply, depending on the types of charities to which the gifts are made, the type of property donated, and, in some cases, how the property is contributed.

For a more detailed discussion, please refer to Prudential's FAQ: *IFS A109291, Charitable Giving: Understanding the Percentage Limitations.*

Q. If a person transfers an insurance policy to a charity, does that person have an obligation to continue to pay the premiums?

A. Once the policy is transferred to the charity it is the charity's obligation to fund future premium payments if it wants to eventually receive the death benefit. If the donor so desires, he or she can make future contributions to the charity to help with this expense – but the donor generally is not obligated to do so.

Q. Is there a "best way" for a donor to pay future premiums on a policy donated to a charity?

A. The donor should make premium payments directly to the charity rather than to the

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insurance company, and the amounts contributed should generally be slightly more than the amount needed for the premium payments.

By making payments to the charity, the insured is more likely to be viewed as making a gift “to” the charity, rather than a gift “for the use of” the charity.

If the IRS characterizes charitable payments as “for the use of” the charity, the deductibility of the premium payments will be lower than if the payment is characterized as a payment “to” the charity.

Q. Can I donate an existing life insurance policy that is subject to an outstanding loan?

A. Donating a policy subject to a loan can result in problems for both the donor and the recipient charity. A gift to charity of a policy subject to a loan could bring into play the bargain sale rules, which require a donor to realize gain. In turn, the charity increases its risk of potential tax problems and penalties regarding unrelated business taxable income (UBTI), self-dealing, and/or jeopardizing investments.

For a detailed discussion of the “why not,” please refer to Prudential’s FAQ: *IFS-A089488, Gifting a Policy with a Loan to a Charitable Organization*.

Q. What type of statement must be provided to a donor who has contributed a life insurance policy to a charity?

A. Provided the value of the policy exceeds \$250, the donor must obtain an acknowledgment of the contribution from the charitable organization before filing an income tax return for the year in which the gift was made.

Generally, an official authorized to sign the charity’s tax forms, will issue an IRS Form 8323, *Noncash Charitable Contributions*, which needs to be attached to the donor’s return. Form 8283 lists information on the donor and the charity, and includes a description of the policy, how and when it was acquired, and its fair market value. Failure to obtain a Form 8283 can result in loss of the charitable deduction.

If the donated policy is worth \$5,000 or more, a formal independent appraisal is required and should be obtained from someone other than the carrier that issued the policy or the producer who sold the policy.

Q. If a charity receives a gift of a life insurance policy that has accumulated cash surrender value, can the charity borrow against the cash value and reinvest the money at a higher rate?

A. While a charity that is the owner of the policy has the right to borrow against cash surrender value, withdrawals and loans may trigger the application of the UBTI rules and corresponding penalties where policy values are used to purchase securities or other income-producing investments.

In addition, withdrawals and loans reduce policy cash values and death benefits, may affect guarantees against lapse, and may have tax consequences.

For a more detailed discussion of the UBTI issue please refer to Prudential’s FAQ: *IFS-A089488, Gifting a Policy with a Loan to a Charitable Organization*.

Q. Can I receive a charitable deduction if I name a charity as beneficiary of a life insurance policy I continue to own?

A. No current income tax deduction is available when a charity is named a revocable or irrevocable beneficiary of a policy you continue

to own. Because you retain control of the policy, the gift is incomplete. Only at your death, if the charitable beneficiary designation is still in place, will your estate receive a charitable deduction for the amount passing to the charity.

For a more detailed discussion, please refer to Prudential's FAQ: *IFS-A079284, Approaches to Making Charitable Gifts of Life Insurance*.

Q. Can a charity directly purchase a policy on my life?

A. A person (or entity) purchasing a life insurance policy must have an "insurable interest" in the life of the person being insured at the time of policy application. State law determines how an insurable interest is defined and applied. Most states have enacted legislation to address insurable interest as it applies to charitable entities and life insurance. The statutes vary widely from state-to-state, and may present unusual requirements or restrictions. It is important in any charitable planning situation involving life insurance to study the applicable state statutes to ensure that the charity has a valid interest in a donor's life.

For a more detailed discussion, please refer to Prudential's FAQ: *IFS A108566, Insurable Interest: Is the Envelope Being Stretched?*

Q. What is a "wealth replacement" trust?

A. In many charitable planning situations, the donor contributes assets with significant value to a charity. While for estate planning purposes this removes current value and future appreciation from the donor's estate, it also raises concerns. Many donors hesitate to make substantial gifts to charity fearing the loss of financial security for their family after their death. The solution is often a "wealth replacement trust."

Under the wealth replacement approach, an irrevocable life insurance trust (an ILIT) is established with the donor's family members as

beneficiaries. The ILIT purchases a policy on the life of the donor or a joint policy on the lives of the donor and spouse. The face amount of the insurance is generally equal to the value of the property given to charity. At the death of the donor (or the last spouse to die), the policy proceeds pass to the family heirs free of estate tax, replacing the value of the property donated to the charity.


Q. How does a charitable legacy plan using life insurance work?

A. A charitable legacy plan uses corporate-owned life insurance to allow a selected executive (or director) to name a favorite charity as the recipient of a corporate gift at his or her death. The corporation is the owner and beneficiary of a life insurance policy on each participant. At the insured's death, the promised sum is paid to the named charity generating a charitable tax deduction for the corporation as well as community goodwill and recognition for the business.

It should be noted that for employer-owned life insurance policies issued after August 17, 2006, IRC §101(j) provides that death proceeds will be subject to income tax; however, where specific employee notice and consent requirements are met and certain safe harbor exceptions apply, death proceeds can be received income tax free. Life insurance proceeds are otherwise generally income tax free under IRC §101(a).

For a more detailed discussion of how a legacy program works, please refer to Prudential's FAQ: *IFS-A080671, Director Charitable Giving Plan Using Life Insurance*.

Q. Recently I have heard references to charitable giving programs referred to by the acronyms of "SOLI" and "CHOLI." Can you help me understand these plans?



A. These acronyms refer to “Stranger-Owned Life Insurance” and “Charity-Owned Life Insurance.”

There are many variations being sold but, in general, the approach is to encourage a charity to borrow money from an outside lender to purchase life insurance on consenting donors. When the donors die, the death benefit proceeds are used to repay the loan and interest, and any excess is paid to the charity. This scenario is often stretched to include individuals with no donation history who, in essence, “lend their lives” to benefit the charity, or introduce third-party investors who have a profit motive.

Questions abound about the abuse of the insurable interest rules and the ethics of these approaches. For a more detailed discussion, please refer to Prudential’s FAQ: *IFS A108566, Insurable Interest: Is the Envelope Being Stretched?*