



Vermont Land Trust

CONSERVING LAND FOR THE FUTURE OF VERMONT

GIFTS OF LIFE INSURANCE TO CHARITY

Many individuals have life insurance policies that can be used to benefit charities when the insured dies or, in some cases, during the insured's life. Such policies, if left to non-charitable beneficiaries at the insured's death, will in most cases pass free of income tax, but they will be subject to estate taxation in the donor's estate, thereby reducing what these non-charitable beneficiaries receive. For this reason, life insurance policies are often excellent assets to use for charitable giving.

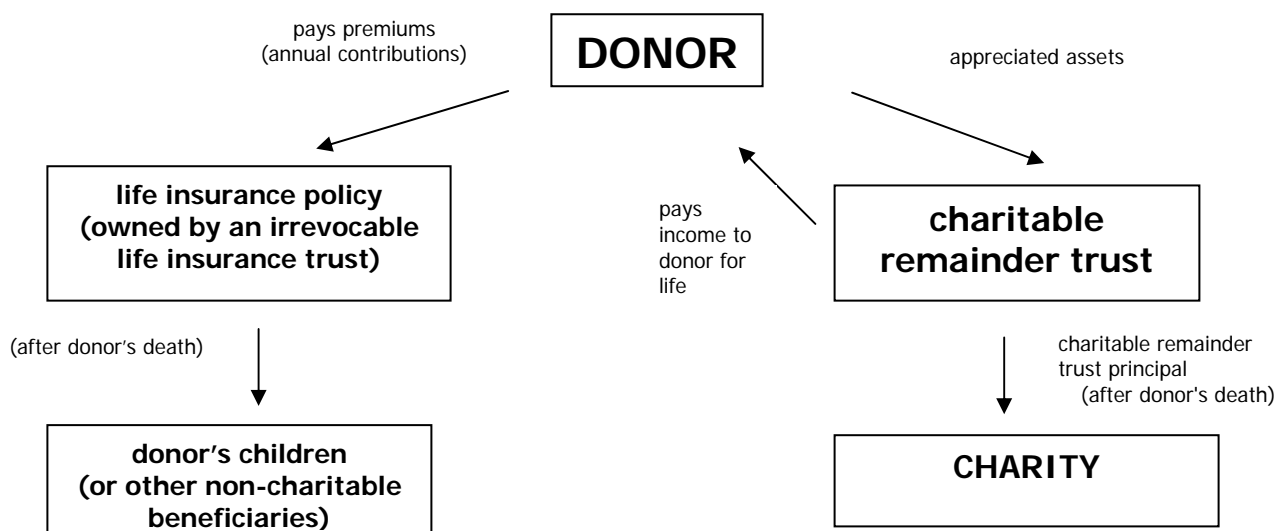
HOW CAN I USE LIFE INSURANCE TO BENEFIT CHARITY, AND WHAT ARE THE BENEFITS OF DOING SO?

Life insurance can be used to benefit charity in three primary ways:

- 1. Designation of charity as beneficiary at insured's death.** A life insurance policy can be used to designate one or more charities as beneficiaries of the policy when the insured dies. Such a designation is typically revocable, and therefore the policy owner (typically the insured) can change the beneficiary during his/her life. Such a gift will generate no income tax benefits for the donor, but it will circumvent estate tax on the insurance death benefit when the insured dies, by passing the proceeds to charity. This can save estate taxes for the insured's estate of up to 46 percent, depending on the size of the estate at the insured's death. Such gifts are easily accomplished by obtaining a change of beneficiary form for the policy in question and completing it to name the charity of one's choice as beneficiary.
- 2. Irrevocable gift of life insurance policy to charity during insured's lifetime.** Alternatively, the policy owner can irrevocably assign the ownership and beneficiary designation of a life insurance policy to a charity during the insured's lifetime, thereby guaranteeing that the death benefit will pass to the charity at the insured's death. If the policy is a whole life or other "permanent" insurance policy that has cash value at the time of the transfer, the donor may be entitled to an immediate charitable income tax deduction equal to the fair market value or adjusted cost basis the donor has in the policy. Typically, the donor's basis in the contract is equal to the aggregate premiums paid, less dividends paid and outstanding policy loans. In addition, when the insured dies, the insurance proceeds will pass free of estate taxation to the charity. Such gifts can be accomplished by obtaining both a change of beneficiary and change (assignment) of ownership form for the policy, and then completing them to designate the charity of one's choice as the new owner and beneficiary. The insurance company can advise you of the fair market value of the policy for charitable income tax deduction purposes.
- 3. Wealth replacement strategy using life insurance.** Individuals with taxable estates may wish to maximize assets passing to individual beneficiaries when they die, reduce estate taxation at death, receive current income tax benefits and make a significant gift to charity at death. An excellent way to accomplish these objectives is through a wealth replacement strategy combining a charitable remainder trust and the use of a lifetime gift of a life insurance policy.

The strategy works as follows:

- A. First step: charitable remainder trust.** The donor(s) create a charitable remainder trust which provides that they will receive a specified amount of lifetime income from the trust as long as they live, and when the last donor dies, the trust assets will pass to one or more specified charities. The donor(s) will receive a charitable income tax deduction upon the creation of the trust, thereby immediately reducing their income tax liability. In addition, they will save estate taxes at death because the assets in the charitable remainder trust will avoid estate taxation in their estates. The charitable remainder assets will not, however, pass to their children (or other noncharitable beneficiaries), thereby somewhat reducing the inheritance to these individual beneficiaries.
- B. Second step: life insurance.** The donor and, if married, the donor’s spouse, can purchase new life insurance coverage on their lives, or use an existing policy, and assign the ownership of and beneficiary on the policy to an irrevocable life insurance trust for the benefit of their children or other non-charitable beneficiaries. Alternatively, the donor(s) may transfer ownership of the policy directly to their children. The donors can use the income tax savings they will receive upon creating the charitable remainder trust to help cover the cost of the insurance premiums. In addition, the annual income the donors receive from the charitable remainder trust can also be used to pay ongoing premiums. Assuming the donor lives at least three years following transfer of the policy to the irrevocable life insurance trust (or to his/her children or other beneficiaries), death benefits will avoid estate taxation when the insured dies. Frequently, donors will purchase new “second-to-die” life insurance on the lives of both spouses. These policies pay out only when both spouses have died, at which point the insurance proceeds will pass free of any tax to the insured’s children or other non-charitable beneficiaries.
- C. The result?** The charity receives the principal from the charitable remainder trust when the donor(s) die. The donor’s children (or other noncharitable beneficiaries) receive the life insurance proceeds free of any estate taxes when the donor(s) die, and the donor(s) receive both income and estate tax benefits as well as added income from the charitable remainder trust.



WHAT ARE THE DISADVANTAGES?

By leaving your life insurance to charity at your death, you will (except in the case of the wealth replacement strategy) reduce the inheritance to your non-charitable beneficiaries. Further, if you have a life insurance policy that has cash value, and you transfer ownership of the policy to charity during your lifetime, you will no longer be able to use the cash value for your retirement or other purposes. Therefore, you will need to be sure your other financial resources will be sufficient for your future financial needs.

Under the wealth replacement strategy, when assets are placed in a charitable remainder trust, the donor(s) will have access to the trust income but will be unable to use any trust principal thereafter. Further, if new or existing life insurance is used, premiums on the policies will likely need to be paid in the future. Typically, donors make annual gifts to their children to be used by them to pay the ongoing life insurance premiums.

HOW DO I GET STARTED?

If you intend to name the Vermont Land Trust as the beneficiary (but not the owner) of a life insurance policy, you need to obtain a change of beneficiary form for the policy from the insurance company in question or from your insurance agent. The beneficiary designation form should be completed to designate the charitable and non-charitable beneficiaries of your choice.

For example, if you wish to name your spouse as primary beneficiary of the policy (if your spouse survives you), and to name the Vermont Land Trust as the contingent (secondary) beneficiary (when your spouse and you have both died), then the form should be completed accordingly. If, instead, you intend to name the Vermont Land Trust as the primary beneficiary, then no contingent beneficiary typically needs to be named. Once the form is completed and signed, it should be returned to the appropriate financial institution for processing to complete the change of beneficiary designation.

If you wish to name the Vermont Land Trust as both beneficiary and owner of the policy, then you need to obtain and complete both change of beneficiary and change of ownership forms from the insurance company. The forms should be completed to designate the Vermont Land Trust as the primary beneficiary of the policy and the new irrevocable owner. Again, the completed forms should be sent to the insurance company for processing.

Finally, if you wish to use life insurance as part of a wealth replacement strategy, you need to work with your attorney to prepare a charitable remainder trust that will be funded with assets you transfer into the trust after its execution. This trust will generate income for you and/or your spouse and will pass to the Vermont Land Trust when the income beneficiaries die. You also need to determine whether you wish to create an irrevocable life insurance trust to hold your life insurance (as the new owner and beneficiary of the policy) or whether you wish to transfer ownership and the beneficiary of the policy to your children (or other non-charitable beneficiaries).

Ownership of the life insurance by either an irrevocable life insurance trust or individuals other than your spouse (who will also be the beneficiaries of the policy) will result in the insurance death benefit avoiding estate taxation at your death. If an irrevocable life insurance trust is used, you will need to consult with your attorney to draft the trust.

The Vermont Land Trust would be happy to prepare an analysis of how life insurance can be used for charitable giving in your particular situation. If you would like further information about this or other forms of gift planning, please contact us.

***Gifts of Life Insurance to Charity* is one publication in a series on charitable giving:**

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To receive a copy of any of these materials, please contact the Montpelier office.
For answers to questions or to learn more about how to include the Vermont Land Trust in your estate plans, contact Darby Bradley, at darby@vlt.org or at the number below.

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