Donate Life Insurance to a Charity or College

PERHAPS YOU have a permanent life insurance policy that you no longer need. Sure, you can cash it out, but if you have altruistic inclinations, you can give the policy to your alma mater or a favorite charity.

Donating life insurance "packs a whole lot more punch" than donating cash, says Kyle Krull, an estate-planning lawyer in Overland Park, Kan. Consider two alumni who each want to donate $50,000 to their fraternity, he says. While one donates $50,000 in cash, the other has paid premiums of $20,000 for a policy that provides $50,000 in death benefits to the frat.

You have two basic choices. You can name a charity as the policy's beneficiary, and the charity will get the proceeds when you die. Or you can transfer ownership of the policy to the charity while you are alive.

Naming a charity as a beneficiary gives you flexibility. You can borrow against the policy and take cash withdrawals, which, of course, will reduce the value of the future gift. If you change your mind, you can name another beneficiary or cash out. You also can split the beneficiaries among two or more organizations—say your college and your local food bank.

Because you're still the owner, however, you cannot take a charitable income-tax deduction. And the charity won't recognize your largesse while you're alive.

If instead you assign ownership to the charity, you can claim a tax deduction for part of the value of the donated policy—up to 50% of your adjusted gross income. You'll also be able to deduct the cash you give the charity each year to pay any premiums that are still owed on the policy.

But once you transfer ownership, you can't change your mind. And it may be tough even finding a charity that will accept your largesse. Only 5% to 10% of charities will accept ownership of a policy during a donor's life, says Bryan Clontz, president of consulting firm Charitable Solutions. "Most charities are not comfortable accepting life insurance," Clontz says. "They would have to manage it until the donor's death." For the charity, he says, watching out for premium checks, sending out receipts and dealing with other administrative issues could be "a pain in the neck."

Still, many community foundations and large organizations, such as Goodwill Industries International and the American Cancer Society, are more amenable than perhaps your local theater group. Some colleges also will consider your donation. In some cases, the charity will require that the policy is paid up.

The Value of Your Gift

To claim a deduction, you will need to get your policy appraised, as you would for any non-cash gift worth more than $5,000. Clontz says a donor can claim the lesser of the adjusted "cost basis" or the fair market value of the policy. The adjusted basis is the total of premiums you paid prior to the donation minus any withdrawals. Ask the insurance company for the adjusted basis "before you make the gift so you know exactly what deduction you will get," he says. In most cases, the adjusted cost basis will be less than the fair market value, which is usually close to the cash value.

Give the charity appreciated securities rather than cash to cover future premiums. If you've owned the securities for more than a year, you can deduct the full market value of the gift even as you avoid the capital-gain tax that would be due if you sold.

Before you donate a policy, review your other assets to make sure doing so would be the savviest way to make your gift. Say you have a traditional IRA worth $500,000 and a policy with a $500,000 death benefit. It may make more sense to give the IRA to the charity and name your children beneficiaries of the policy, Krull says. The kids would get the death benefit tax free, but they would have to pay income tax when they tap the IRA. K —SUSAN B. GARLAND

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