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Charitable donations

1. Is a receipt required for charitable gifts to obtain an income tax deduction?

For a gift to charity with a value of $250 or more (whether the gift is a cash gift or gift of property), the IRS requires the donor to have a statement from the charity showing:

(1) the amount of money contributed and a description (but not the value) of any property donated, and

(2) whether the charitable organization provided any goods or services in return for the donor's contribution. If goods or services were received, a description and estimate of the value must be provided.

In determining whether the donor needs to obtain this written acknowledgment from the charity, separate donations should not be combined. For example, if the donor gave $25 to their church each week for a total of $1,300, this donor could treat each $25 donation as a separate gift for which a written acknowledgment would not be required.

If a written acknowledgment is required, the donor must obtain it from the charity by the date they file their tax return or their tax return is due, whichever occurs earlier. See IRC §170(f)(8). The date of the acknowledgment is important as demonstrated by a tax court case (*Durden v. Comm'r,* TC Memo 2012-140), which denied taxpayer a deduction for charitable gifts of over $250 because a proper receipt was not obtained from the charity within the time allotted.

Donating a life insurance policy to a charity

2. Is an appraisal required when donating a life insurance policy to charity?

It depends. If an income deduction is sought by the donor and the amount claimed or reported as a deduction with respect to donated property exceeds $5,000, the taxpayer is required to substantiate such donation with a "qualified appraisal" as provided by Treas. Reg. §1.170A-13(c). If no income tax deduction is sought, a qualified appraisal on property donated to a charity is not necessary.

3. What is the value a donor receives when gifting a life insurance policy to a charity?[1]

The income tax deduction for a donated life insurance policy generally depends on how long the policy has been in force.[1]

- For a new policy (in the first year), the deduction is generally the initial premium.
- For an inforce policy (two years or more), the deduction is equal to the lesser of the donor's basis in the policy or fair market value.

4. Does a donor of a life insurance policy receive an income tax deduction if the beneficiary designation is irrevocably made to a charity?

No. A current income tax deduction is unavailable, even if the beneficiary designation is irrevocable. To obtain a current income tax deduction, the charity must become the owner and beneficiary of the policy.

5. Are there limitations on the income tax deduction for a charitable gift of a life insurance policy?

The value of the deduction may be limited annually due to the type of charity the policy was gifted to.

- **Public charity:** maximum annual deduction is 50% of AGI
- **Private charity:** maximum annual deduction is 30% of AGI

If the entire value of the charitable gift cannot be deducted in the year in which the gift is made due to AGI limitations, the remaining value may be carried over for five additional tax years.

Donating a life insurance policy to a charity, continued

6. When transferring the ownership of a life insurance policy with a loan to a charity, what is the value of the charitable contribution for income tax purposes?

An income tax deduction may be unavailable if there is an existing loan on the policy at the time of transfer.[2] Gifts of a policy with a loan will be deemed a part gift/part sale when made to a charity. Unlike gifts to non-charitable beneficiaries, the donor must allocate their basis between the gift portion and the sale portion. Thus, only the amount of the donor's adjusted basis which is apportioned to the gift to charity may be considered a deductible charitable contribution.

For example, consider a 10-year-old policy with a basis of $500,000, a fair market value (FMV) of $2,000,000, and a loan of $1,500,000. In this case the loan is 75% of the FMV, which causes the allocation of the basis as 25% gift and 75% sale. Hence, the basis would be allocated as follows:

- The gift portion would be $125,000 (25% of basis),
- and the bargain sale portion would be $375,000 (75% of basis).

As a result, the value of the charitable contribution reported on Schedule A of Form 1040 would be only $125,000. Therefore, the donor of the policy will recognize ordinary income on the loan amount up to the gain on the policy, or $1,125,000 in this example ($1,500,000–$375,000).[3] Clients should consult their tax professional regarding transferring a life insurance policy with a loan to a charity.

Charitable ownership of a life insurance policy on a donor

7. Does a charity have insurable interest over a donor's life?

Generally, yes. In most states, insurable interest rules permit the charity to own a policy on a donor's life. Check local state statutes for specific limitations.

8. For financial underwriting purposes, is it sufficient for the proposed insured to merely be a donor to a charity?

Generally, no. For the charity to insure a donor's life, there must be a connection between the two, such as:

- an established pattern of monetary gifts;
- bringing on other donors;
- a strong affiliation (e.g., alumnus, board member);
- providing other forms of ongoing support or professional services; and
- a long-standing connection with the charity (length of time, in what manner) or another connection to the charity.

9. Can a donor lend money to the charity (known as private financing) to purchase a policy?

No. The use of private financing is not permissible under the charitable split dollar rules of IRC § 170(f)(10). In addition, private financing with a private foundation would be not permissible, as it would be considered self-dealing.

10. Can the charity use third-party premium financing to help it purchase life insurance on a donor's life?

Assuming a charity has an insurable interest to purchase the policy under a state's insurable interest rules, the charity may borrow funds and use them to purchase a life insurance policy. However, Congress has been looking at this issue in the context of concerns over Investor Owned Life Insurance (IOLI). There does not appear to be any immediate issue with regard to unrelated business taxable income (UBTI) because the cash value in the policy grows on a tax-deferred basis. However, it is important to avoid creating Modified Endowment Contracts (MECs) in this type of transaction. Withdrawals and loans from a MEC in a gain position are accorded "last in, first out" (LIFO) treatment, rather than "first in, first out" (FIFO) treatment under IRC §72. Therefore, UBTI will be generated immediately upon any such withdrawal or loan.[4]

Charitable trusts

11. Can life insurance be used in a Charitable Lead Trust (CLT)?

Yes, life insurance can be an attractive funding source for a CLT. However, a number of important considerations must be kept in mind. First, it is essential to have sufficient additional assets in the trust available to pay the annual minimum of 5% income to the charity. Secondly, it is important to make sure that no income is ever applied to pay the life insurance premiums.[5] This may include tracing income that is accumulated and added to principal and never used to pay premium. Lastly, an attorney should review IRC §170(f)(10) to determine its applicability to the ownership of life insurance by a CLT.

12. Is life insurance a permissible funding source in a Charitable Remainder Trust (CRT)?

Yes, life insurance can be purchased in a CRT. The CRT must have sufficient assets to pay the annual income amount to the non-charitable beneficiary. Additional consideration must be given to the IRS position in PLR9227017, where the IRS stated that the death benefit must be allocable to the charitable remainder paid to the charity. This may mean that only a Net Income Charitable Remainder Unitrust (NICRUT) or Net Income with Makeup Charitable Remainder Unitrust (NIMCRUT) is acceptable to purchase life insurance.

13. Can the donor use life insurance in an Irrevocable life insurance trust (ILIT) to replace wealth transferred through a Charitable Remainder Trust (CRT)?

Yes, the donor can purchase life insurance in a "wealth replacement trust" (WRT), which is an ILIT, to replace the assets transferred to the CRT. The donor can use the annual after-tax income from the CRT to fund the life insurance premium.

1. Please see Internal Revenue Code (IRC) §170 for specific rules regarding charitable deductions. If you donate property that has a fair market value less than your cost basis, your deduction is generally limited to the lower fair market value.

2. A donor's deduction for both the gift of a policy subject to a loan and any subsequent premiums contributed to a charity may be denied under the charitable split dollar rules of IRC §170(f)(10).

3.Because of self-dealing and/or jeopardizing investment rules that may apply, the charity should consider whether it is a prudent investment to continue the ongoing premium payments on the policy, if applicable, and for how long, or whether or not surrendering the policy may provide a higher benefit.

4. Loans and withdrawals will reduce the death benefit, cash surrender value, and may cause the policy to lapse. Lapse or surrender of a policy with a loan may cause the recognition of taxable income. Policies classified as modified endowment contracts may be subject to tax when a loan or withdrawal is made. A federal tax penalty of 10% may also apply if the loan or withdrawal is taken prior to age 59½. Cash value available for loans and withdrawals may be more or less than originally invested.

5. If income from a CLT is used to purchase life insurance, the CLT may be characterized as a grantor trust, in which case the trust principal (and any life insurance) may be includible in the grantor's taxable estate and trust income will be taxable to the grantor.

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