



Gifts of Life Insurance

*Existing, New &
Paid-up Policies*

Most people have some type of life insurance, but few understand what a flexible tool it can be for financial planning. Insurance is not just protection for emergencies: It can allow you to accumulate funds on a tax-sheltered basis to supplement your retirement income, provide replacement income for your dependants if something should happen to you, or help you and your family pay for anticipated future expenses such as children's education.


This guide gives an overview of various types of life insurance. Like other financial instruments, different types of insurance are appropriate to different stages of life. What is best for parents of a young family will change once the children are grown. Later on in life, insurance can be an important tool for estate planning or for use in charitable giving.

TYPES OF LIFE INSURANCE

Life insurance takes many forms, all serving the same basic purpose: to provide cash to meet the needs of survivors at the insured person's death. Depending on the policy, life insurance may have a cash value that can be drawn upon before death. Anyone buying insurance can choose among policies intended for investment purposes, with emphasis on increasing cash value. There are three different types of life insurance policies:

1. Term Life Insurance maximizes the death benefit payable if the insured person dies within a specified time. It is popular with those who need the maximum protection at the lowest cost. Young parents primarily concerned about financial security for their family often purchase it. If you purchase term insurance, you are paying for the risk of your death year by year, and coverage will continue as long as you pay the premiums. The cost of premiums normally increases with age. Term life insurance does not accumulate cash value.

2. Whole Life Insurance combines a death benefit with predictable growth in cash value. The premium and death benefit usually are fixed, and the cash value grows according to a predetermined schedule, though some policies also pay dividends, which may be



used to purchase additional paid-up insurance. Depending on the policy, the premiums may be payable for life or for a term of years, with the policy being fully paid-up at the end of that term. You may surrender the policy for cash value, or borrow all or a portion of the cash value while keeping the policy in force.

If you purchase a whole life policy when you are young, you will pay a higher premium than for term insurance because you are investing in a cash value account as well as covering the risk of dying.

3. Universal or Variable Life Insurance places greater emphasis on growth. The premium and/or the death benefit may change, and growth in cash value depends on investment performance. Premiums may continue throughout the insured person's life or end when sufficient reserves are accumulated to sustain the policy. Large initial premium deposits may make future premiums unnecessary.

Group insurance policies are often offered by an employer or through an individual's affiliation with an organization. Policies provided by an employer have no cash value to the employee but are designed to provide at least a minimal level of life insurance in the event of the employee's death. Any of these policies can have an important role in a person's financial plan. As time passes, however, the original reason for the policy may become less important.

Policies with a face amount that once seemed large can become insignificant with inflation. As young children get older and their parents accumulate other resources, the need for family financial protection may decrease. Policies purchased in the past to provide cash for estate settlement may have become less necessary since the repeal of the Succession Duty and Estate Tax.

TAXATION OF LIFE INSURANCE

Life insurance proceeds received at the death of the insured person generally are not taxable. This is one reason life insurance is so valuable: it provides tax-free cash at a time when family members are distracted from their normal activities and funeral expenses

must be paid. The proceeds of a life insurance policy can provide a financial cushion at such a stressful time.

Policies that accumulate a cash value can be surrendered for cash, resulting in tax consequences: any excess of the cash surrender value over the adjusted cost base (ACB) of the policy is taxable to the policyholder. "Adjusted cost base" is determined as follows:

- 1) For policies acquired before 12/2/82, "adjusted cost base" refers to the total premiums paid with certain adjustments.
- 2) For policies acquired after 12/1/82, "adjusted cost base" refers to total premiums paid less the net cost of pure insurance for all years the policy has been in force, again with certain adjustments.

These rules mean that policies acquired after 12/1/82 are likely to have more taxable gain upon surrender. If you plan to cash in a policy, your insurance company should be able to provide the "adjusted cost base" for you. But remember, these rules apply only if a policy is surrendered for cash. If proceeds are received because of the death of the insured, they are not taxed, no matter what the adjusted cost base.

OWNERSHIP RIGHTS

Ownership rights in an insurance policy consist of several contractual rights over the policy and its benefits. These include the right to surrender or cancel the policy, change the beneficiary, assign the policy, borrow against the cash value of the policy and choose a settlement option. Collectively, these are called the "incidents of ownership."

The incidents of ownership can be assigned either to another person or to an organization. (Insurance can be an excellent way to make a charitable gift at a modest cost.) Once ownership is reassigned, the decision is irrevocable, so it should be considered carefully.



POSSIBLE BENEFICIARIES

While most people think of family members as beneficiaries of an insurance policy, it is also possible to name your estate or a charitable organization as beneficiary—or to create a trust with life insurance proceeds. These options are briefly described below.

Estate: Naming your estate as beneficiary of a life insurance policy provides liquidity that can be very helpful, particularly if significant taxes will be due for the year of death. (A disadvantage, however, is that the proceeds of the policy become part of probate for the estate, and therefore are subject to probate fees.)

Family Members: Spouses and children are most frequently named as beneficiaries of insurance policies that are, after all, usually purchased as a means of providing for their financial security. For most policies, it is possible to name a primary beneficiary (such as a spouse) and contingent beneficiaries (other family members) in the event that the spouse named as beneficiary does not survive the insured person.

Organizations: Naming an organization as beneficiary of an insurance policy can allow you to make a substantial charitable gift at a modest cost. This can be done either by changing the beneficiary designation of an existing policy or by purchasing a new policy. Because beneficiary designations can be changed—unlike assigning ownership of a policy, which is irrevocable—naming a charitable organization as beneficiary does not qualify you for a donation receipt, whether the policy is old or new. However, if the charity remains the beneficiary, it will issue a donation receipt to your estate when it receives the death proceeds. This can reduce the taxes payable at the end of your life.

Life Insurance Trust: It is possible to name a trust as the beneficiary of your life insurance policy, and this may have advantages. For one thing, a trust can disburse funds over time rather than all at once—which may be better for your beneficiaries. Also, you can give a trustee latitude on investment decisions or restrict decision-making,

according to your goals for the trust. Life insurance trusts can satisfy a variety of objectives, and they have different tax consequences depending on how they are structured.


CHARITABLE GIFTS OF LIFE INSURANCE

Using life insurance policies to make charitable gifts has many advantages: You can make a large gift while paying for it in installments (the annual premiums on the policy). If a church or charity is named as beneficiary or owner of the policy (or both), as long as the premiums are paid, the church or charity will receive the amount stated in the policy. The insurance proceeds are also guaranteed to be paid out promptly. Finally, life insurance can allow you to make a substantial gift without reducing assets intended for other family members. Some of the ways to make a gift of life insurance are described below:

Give a paid-up policy: If you have a policy you bought years ago to meet a need that no longer exists, you can give the paid-up policy to a charity and receive a donation receipt for the cash value. (If the cash value exceeds your adjusted cost base, you will have taxable income equal to the difference as a result of the gift.)

Example: At age 74, Carla K. is thinking about making an endowment gift to charity and wants to do something during her lifetime. Although she depends on income from her investments, she remembers that she has a paid-up \$50,000 life insurance policy she no longer needs. By making the charity both the beneficiary and the owner of the policy, she receives a donation receipt for the policy's cash value. Her gift is irrevocable and claimable for up to 75 percent of her income (the excess can be carried forward up to five years).

Give an existing policy on which premiums are still owing: Carla's policy was paid up, but if she still owed premiums and continued to pay them, she would receive donation receipts for those payments as well as for the cash value of the policy. She could make the premium payments directly to the insurance company or make



annual gifts to the charity, which would use her gifts to pay the premiums. In either case, the charity would send her a donation receipt.

Purchase a new policy and transfer ownership to the charity or church you want to benefit: If you do not have an existing policy you no longer need, and if you want to assure a major future gift but cannot afford to do so with your present assets, you can purchase a new life insurance policy and transfer ownership to the charity or church of your choice. If insurability laws in your province allow, you and the church may even be co-applicants on the policy. You would receive a donation receipt for the premiums you pay, since a new policy normally will not have any cash value to transfer.

Example: Greg H., aged 43, would like to make a substantial gift to charity. He has no existing insurance policy to contribute, nor does he have sufficient assets for a major outright gift, but he does have discretionary income. He purchases a new \$40,000 policy, naming the charity as both owner and beneficiary. He makes five annual payments of \$1,200 each, receiving a donation receipt for each payment. Assuming a combined federal/provincial tax credit equal to 46 percent of the donation receipts, his tax savings are \$2,760. Thus, his “net cost” for each premium is only \$648, and he makes a future gift of \$40,000 for a total net cost of only \$3,240 (annual payments-tax savings).

Name the charity or church as beneficiary: If you want to retain ownership of a life insurance policy in order to have access to its cash value, you can still use it to make a future gift to charity by naming the charity as the beneficiary. It is possible to name an organization as primary beneficiary (to receive all proceeds of the policy), as co-beneficiary (proceeds will be divided, perhaps benefiting a family member and the charity), or as a contingent beneficiary (proceeds will go to a family member or other individual, unless that person predeceases the insured person—in which case proceeds will go to the charity).


Example: Morgan R. and his wife no longer need the \$50,000 death benefit from a policy he bought when their children were young, but they want to retain ownership of the policy in case their circumstances change. They decide to have Morgan name two charitable organizations as equal beneficiaries of the policy's proceeds. When he dies, his estate will receive donation receipts of \$25,000 from each organization (\$50,000 total), resulting in significant savings on his final tax return. If the donation receipts exceed 100 percent of his income in the year of death, the excess can be carried back to the previous year, again subject to the 100-percent-of-income limitation.

Name your estate as beneficiary and provide a bequest to charity: Another course of action is to name your estate as beneficiary and provide in your will for charitable bequests equal to the death proceeds from your policy. Prior to the 2000 federal budget, this was the only way your estate would receive a donation receipt. However, charities and churches can now issue receipts when proceeds are paid to them directly as beneficiaries.

LIFE INSURANCE AS WEALTH REPLACEMENT

Some individuals considering a charitable gift—whether in the form of cash, securities, real estate or artwork—are concerned about diminishing the legacy intended for their heirs. One possible way to resolve this dilemma is to purchase life insurance having a face value equal to the donated asset and to name children or other heirs as beneficiaries. If the asset is given to charity outright, the tax credit is often large enough to pay the premium needed to purchase the insurance policy.

Example: Jeff and Stephanie want to contribute a piece of art appraised at \$100,000 to charity, but they don't want to reduce their children's inheritance. The tax credit from the gift amounts to \$46,000 over several years. They use a portion of the savings to purchase a second-to-die policy that will pay \$100,000 to the children when the surviving spouse dies.



If Jeff and Stephanie decided not to make an outright gift, they could contribute assets to a charitable remainder trust and receive both income for life and a donation receipt for the present value of the trust principal that will eventually be distributed to the charity. Part of their trust income, as well as the tax credit from the donation receipt, could then be used to pay premiums on a life insurance policy that would replace the value of the donated asset for their heirs.

Example: At ages 68 and 67, Jeff and Stephanie contribute bonds valued at \$200,000 to a charitable remainder trust. They receive the net income from the bonds, which in this case is \$14,000 per year. Moreover, they are entitled to a donation receipt for \$48,427. Assuming the combined federal/provincial tax credit is 46 percent of the gift, this receipt results in a tax credit of \$22,276. They then purchase a \$200,000 life insurance policy, naming their children as beneficiaries, and they use the dollars saved through the tax credit plus some of the trust income to pay the premiums. Through this arrangement, they make a future gift to charity, protect heirs, and preserve adequate cash flow for themselves.

CONCLUSION

Life insurance can play many roles in financial and estate planning. It can provide financial security for young families and a more comfortable retirement as parents grow older. It can pay funeral expenses or fund capital gain tax liability that arises in an estate. It can be transferred as a gift to a family member or a charity.

Your need for insurance will change as your income, assets—and even your children—grow. By thinking of insurance as a flexible (rather than a fixed) asset, you can use it to meet your family's needs and accomplish other goals that are important to you, during your lifetime and beyond.

All examples are current as of September 2006 and are subject to change.



About Siloam Mission

As a Christian humanitarian agency, Siloam Mission is a connecting point between the compassionate and Winnipeg's less fortunate.



Siloam Mission alleviates the hardships of poverty and homelessness as Mission staff, volunteers and donors provide free meals, shelter, clothing and support services.



The Mission assists in transitioning homeless and disadvantaged people to more self-sufficient and healthier lifestyles by providing referral services, life-skill development, education upgrading and employment training opportunities.



Financial Planning

The information in this booklet does not constitute legal or financial advice and should not be relied upon as a substitute for professional advice. You should always seek professional legal, estate planning, and financial advice before deciding on a course of action.



If you would like information on other methods of planned giving, please contact us and we would be glad to assist you in whatever way we can.



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