



CAPE COD  
HEALTHCARE  
FOUNDATION

# Planned Giving

An Investment in Cape Cod's Future

## Life Insurance: A Flexible Asset

The composition of portfolio assets varies from person to person, but one almost universally accepted asset is life insurance. It is an unrivaled source of protection against economic loss suffered in the event of premature death, and it is commonly used to fulfill philanthropic objectives as well.

Life insurance protects so effectively because it is the only asset that guarantees funds will be available when needed most. Many people think of life insurance only as emergency funding, but it can be a much more flexible asset. This guide explores the versatility of life insurance.

### Adapting to Change

Life insurance companies continually create new products to meet changing needs and circumstances. Individuals, likewise, need to adjust their insurance programs as situations change. Marrying, having children, starting a business—all create special insurance needs. The

approach of retirement is also the time to reexamine an insurance program. If your children are well established and you have sufficient liquidity, you may want to convert a policy to an annuity or surrender it and invest the cash value. Another possibility is to convert your insurance to paid-up policies, which reduces the face amount but eliminates premiums.

Life insurance industry statistics show that many people elect to continue their life insurance policies through retirement to provide cash for estate-settlement purposes. Life insurance is an excellent source of liquid funds for payment of state and federal estate taxes and other costs. For an estate with a large percentage of illiquid assets—such as real estate, business interests, or works of art—life insurance may be the only practical way to provide needed liquidity.

An insurance policy originally purchased to protect your family against loss can be used at probate to provide estate conservation, protecting your estate against shrinkage through lack of liquidity.

## To Whom Can Life Insurance Proceeds Be Payable?

Life insurance proceeds are paid to a named beneficiary, which could be an individual, your estate, our organization, or a trust. You can name more than one beneficiary and indicate the percentage of proceeds that each will receive.

If you want the proceeds to be available to cover taxes and administrative expenses, you might name your estate as beneficiary. However, if you do so, those proceeds will become part of your probate estate, subject to creditors' claims and distributed per the terms of your will. The proceeds are also potentially subject to estate taxes whether or not the beneficiary is an individual or your estate. (See below.)

## Are Insurance Proceeds Taxable?

Proceeds paid to a beneficiary are generally exempt from income tax, and this is one of the major advantages of life insurance. However, the proceeds will be includible in your estate and potentially subject to estate tax if you retained any incidents of ownership. These include the right to surrender the policy for cash, to change the beneficiary, to assign the policy, to borrow against the cash value of the policy, and to choose a settlement option. If at death you possess any of these incidents of ownership in the policy, the full amount of the proceeds will be included in your gross estate for federal estate-tax purposes. However, unless your taxable estate exceeds the federal estate-tax exemption (\$15 million in 2026), no federal estate tax will actually be payable.

Certain states have a state estate tax and/or a state inheritance tax. Since the exemption level for state estate tax is generally lower than the federal exemption,

it is possible that insurance proceeds included in your estate could be subject to state estate tax—even if not to federal estate tax.

If you reside in a state with an inheritance tax, proceeds payable to individuals may be fully or partially exempt from the state's inheritance taxes—but they may be subject to those taxes if paid to your estate and then distributed as bequests to various individuals.

## How Can I Make Gifts of Life Insurance to My Family Members?

The most common way, as noted above, is to name family members as beneficiaries of the death proceeds of a life insurance policy. However, there may be occasions when you would like to transfer ownership of a life insurance policy to a family member while you are still alive. That person would then be entitled to name the beneficiary, including himself or herself, could surrender the policy for cash, or could borrow against it.

If you transfer ownership of a policy to a family member, you make a taxable gift to that person equal to the value of the policy. If that value does not exceed \$19,000 (\$38,000 if you and your spouse agree to gift splitting), the gift is excluded from taxation. If the value is over the excludible amount, you pay no federal gift tax unless your combined lifetime gifts exceed the lifetime exemption for taxable gifts and bequests (\$15 million in 2026 as noted above). Since very few people have estates of this size, most people need not be concerned about the federal gift tax when transferring ownership of a policy to family members.

## Can I Transfer Ownership of a Life Insurance Policy to Your Organization?

Yes, you may transfer ownership of an old policy with accumulated cash value, or you may purchase a new policy and name us as owner. We, like an individual owner, would then have all rights pertaining to the policy. If the policy is not paid up, you may continue to make premium payments—either directly to the insurance company or by making gifts to us, which we use to pay the premiums.

You would be entitled to an initial income-tax charitable deduction for the fair-market value of the policy less the difference between the cash value of the policy and net premiums paid. You would also be entitled to deductions for any premiums you pay after transferring ownership.

Determination of the fair-market value depends on the type of policy transferred. If the policy is fully paid up or is a single-premium policy, its fair-market value is the cost of replacing it with a comparable contract given the insured's age and state of health. For policies that have been in existence for some time, but premiums are still payable, the fair-market value will usually be slightly more than the cash value of the policy—though the fair-market value could be higher, depending on the life expectancy of the insured. For a newly issued policy, the deduction would be the premium paid after the application on which we are named as owner. The fair-market value of a policy is determined by an appraisal taking into consideration all relevant factors, including information provided by the insurance company about the policy.

**Example:** A number of years ago, Mrs. C purchased a whole life policy with a face value of \$100,000 to ensure her children's education in case she died prematurely. The appraised fair-market value of her policy (approximately the same as the cash value) is now \$20,000, and the net premiums she has paid total \$18,000. The premiums are \$1,500 per year. Meanwhile, she has made other arrangements for her children's education, so the policy is no longer needed for that purpose.

Mrs. C assigns ownership of the policy to our organization and receives a charitable deduction of \$18,000 [ $\$20,000 - (\$20,000 - \$18,000)$ ]. If Mrs. C itemizes her deductions, the amount of charitable gifts she can claim is her total contributions minus a floor, which is .5% of her adjusted gross income. This floor is the portion of her gifts for which a deduction is not allowed. Given her 24% tax bracket, the gift results in tax savings of approximately \$4,320. In future years, she contributes \$1,500 per year to cover the premiums, and each contribution results in additional approximate tax savings of \$360. If she made premium payments directly to the insurance company, her tax savings would be the same.

## What Are the Practical Advantages of Transferring Ownership of a Policy to Your Organization?

Aside from the tax benefits, transferring ownership offers a number of practical advantages:

- If the policy is no longer needed for its original purpose, you would be putting an idle asset to work.
- You can fund a large future gift on the installment basis.

- As long as the premiums are paid, the benefit to us is guaranteed—normally proceeds not less than a stated amount.
- Insurance proceeds are paid promptly, and they are not subject to the delays and costs of the probate process.
- A substantial gift can be made without impairing other assets intended for family members.

## What Are the Advantages of Naming Your Organization as Beneficiary of a Policy?

If you want to have access to the cash value of a policy if you ever need it or if you want to retain the right to change the beneficiaries of a policy depending on family circumstances, then you can retain ownership of the policy and name us as beneficiary of the proceeds. Another possibility, if you want to make a future gift but also provide for family members, is to name us as beneficiary of a certain percentage of the proceeds and family members as beneficiaries of the remaining percentage.

Since you retain ownership of the policy and could remove our organization as a beneficiary, you are not allowed an income-tax charitable deduction. However, if you do not remove us as a beneficiary and we receive proceeds at your death, your estate will be allowed an estate-tax charitable deduction equal to the amount of the proceeds. In the event that you had named your estate as beneficiary of the policy proceeds and provided for a bequest in your will, an estate-tax charitable deduction would be allowed for the amount of the bequest.

## How Can I Make a Charitable Gift in a Way That Protects Survivors?

**Provision for a spouse:** If insurance proceeds are needed to support a surviving spouse, they could be paid to a charitable remainder trust. The spouse would be entitled to payments from the trust until death, when the remaining principal would be distributed to our organization.

This arrangement has several advantages. The insurance proceeds will be paid promptly to the trust, and the surviving spouse will start receiving payments immediately without waiting for probate to be concluded. The spouse can be relieved of investment responsibilities. None of the proceeds will be subject to estate tax.

If you want to allow invasion of principal for health and other special needs of the spouse, you could choose a special kind of trust called a qualified terminable interest property (QTIP) trust and name us as beneficiary of whatever principal that remains.

**Provision for children:** Some people hesitate to make a major charitable gift because they do not want to diminish their children's legacy. One solution is for the parent, while living, to contribute property—such as securities or real estate—for a charitable remainder trust and then to use the tax savings and a portion of the trust payments to pay the premiums on a life insurance policy of which the children are beneficiaries. This kind of arrangement is called *wealth replacement* because the insurance proceeds replace for the children the asset that was donated.

**Example:** Mr. S, aged 65, contributes securities valued at \$300,000 for a charitable remainder unitrust that will pay him 6% of trust assets as revalued each year. At the same time he purchases a life insurance policy with a face value of \$300,000. The trust payments to him (initially \$18,000 per year) are more than enough to cover taxes on the trust payments plus the \$11,000 per year premium. In addition to whatever remains for him after incurring these costs, he receives a charitable deduction for \$109,578—which significantly reduces his income tax. The exact amount Mr. S can claim as a charitable deduction depends on two factors, the total amount of his charitable gifts (including the deduction described here) and his adjusted gross income. Through this arrangement his children will receive \$300,000, not subject to income tax, as a replacement for a future gift to our organization.

- Your estate is large enough to be subject to the federal estate tax, and possibly state estate tax as well, and you would like to pass proceeds to heirs while minimizing estate taxes. In this case, you might have an insurance policy owned by a life insurance trust and make regular contributions to the trust to cover the premiums. Properly structured, this arrangement may keep the insurance proceeds out of your taxable estate.

## Final Note

Life insurance is an exceptionally versatile asset and can be used to meet a wide variety of financial- and estate-planning objectives. If you would like to explore the options available for making a gift through your life insurance, please call or write us.

## When Might It Be Advantageous to Create a Life Insurance Trust?

Instead of having your insurance proceeds paid to individuals, to your estate, or to us, you could have them payable to a trust. Here are some scenarios when naming a trust as beneficiary could make sense.

- You would like for the proceeds to be invested to provide income to a surviving spouse but have the remaining principal go to our organization. The beneficiary could be a charitable remainder trust that would pay a specified percentage to the spouse and then distribute the remainder to us. If you would like to leave open the possibility of invading principal for the spouse's needs, it would be a QTIP trust (noted above) that permits distributions of principal as well as income.
- You would like for the proceeds to be part of the legacy for children, but you prefer to give them the security of payments over time rather than a lump sum. Perhaps you want to place certain restrictions on the distribution of assets.



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