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CESTNICK

TAX MATTERS

Four ways to help out your favourite charity with life insurance

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I can still remember my conversation many years ago with an insurance adviser who later became a good friend. He was selling me different types of insurance and said, “Okay Tim, who looks after life, homeowner’s and car insurance. Now, how about some alien abduction insurance?”

“Uh, I’ll go home and speak to Carolyn about that, then I’ll get back to you on it,” I said.

“That’s fine Tim, you go home, and if you’re still here in the morning, give me a call.”

You’ve got to love the creativity and persistence of a good insurance professional. Today, I want to talk about some creative ways to use life insurance – maybe a policy you already own – to help your favourite charities.

Name a charity as beneficiary. You can take a policy that you currently own, or will buy, and name a charity, or more than one, as beneficiary of the policy. You won’t be entitled to a donation tax credit for the annual premiums on the policy, but your estate will be entitled to a tax credit for the value of the death benefit when the proceeds are paid out to the charity after your death. Generally, this donation credit can be used to reduce the taxes owing in the year of your death, the year prior to your death or in the estate itself (and can be carried forward for up to five years in the estate).

Make a gift through your will. Similarly, you take an insurance policy that you own and name your estate as the beneficiary of the policy. Then, leave instructions in your will for your executor to donate the proceeds to charity once received by your estate. This can work if you’re not sure which charities to help and you want to leave this decision to your executor. The problem, however, is that the insurance benefits could be added to the value of your estate subject to probate fees in provinces or territories that levy this type of tax. Further, if the insurance is paid into your estate, it could be subject to the claim of creditors or tied up in litigation if someone challenges your will. So, this idea is not often recommended.

Transfer a policy to a charity. You could transfer ownership of an existing life-insurance policy to a charity. The charity will become the owner and beneficiary of the policy. Upon your death, the charity will receive the insurance proceeds. When you transfer the policy, you'll be considered to have disposed of the policy at its current value, which is generally the cash surrender value (CSV) under our tax law. If this is higher than the adjusted cost base (ACB) of the policy (you'll need to find out the ACB from the insurance company) then this will trigger a policy gain, which, unlike a capital gain, is taxed as regular income. The good news? You'll also be entitled to a donation tax credit for the fair market value (FMV) of the policy on the date of the transfer.

Interestingly, this FMV could be higher than the CSV of the policy – and sometimes by a big amount if, for example, your life expectancy is shortened. So, you could have a donation tax credit that goes much further than simply offsetting the taxable policy gain and could offset tax on other income as well. You'll need an actuary to determine the FMV of the policy before making the transfer. I should mention that it's possible our tax law may deem the FMV of your policy to be the same as the ACB if the policy was acquired less than three years before the transfer is made to the charity, or less than 10 years before the transfer where it's reasonable to conclude that one of the main reasons for buying the policy was to later make a donation of the policy to charity.

Finally, while you won't be entitled to a donation credit for the amount of insurance proceeds paid out on your death with this idea, you'll be entitled to a donation tax credit for the premiums that you pay each year on behalf of the charity.

Buy a policy for a charity. Like the last idea, the charity will be the owner and beneficiary of the policy. But you won't have a potentially taxable disposition of the policy or a donation receipt for the FMV of the policy as with the last idea. But like the last idea, you'll be entitled to a donation tax credit for any premiums you pay each year on behalf of the charity. You won't be entitled to a donation tax credit for the insurance proceeds paid out on your death.

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