The Stan Clark Financial Team's

PERSPECTIVES

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Financial and estate planning

The advantages of charitable life insurance

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There are many benefits to charitable giving. There is the satisfaction of giving back to the community and helping those in need, to the tax credits that can provide significant relief during your lifetime and minimize future taxes payable by your estate. Whatever your objective, choosing to support a charity is an important and personal decision that helps not only the charity – but you as well.

The Canadian government provides a number of tax incentives designed to encourage charitable donations. In brief, the maximum charitable donation eligible for a tax credit is:

- Up to 75 percent of net income in the year
- Up to 100 percent of income for donations made in the year of death and preceding year.

There are many different types of charitable gifts, each with its own advantages and tax implications. It is important to review and understand the basic features of each gift so that you may choose the option that best suits your needs and financial circumstances.

One such gift is *life insurance*. If you're interested in making a large donation at a relatively small cost, donating a life insurance policy to charity may be an option for you to consider. The donation of life insurance offers many advantages that are not available with other gifting options. A life insurance policy typically avoids or reduces estate taxes, and you can structure your gift to decide when you will receive the tax credits.

There are several ways to incorporate life insurance into a charitable giving strategy:

- A charity can purchase a life insurance policy on your behalf and issue a tax receipt immediately for the premiums you pay directly to the insurance company. The charity will receive the insurance proceeds upon your death.
- You can transfer ownership of an existing policy to a charity. The charity will issue a tax receipt for the fair market value of the policy. Generally this is the cash surrender value of the policy, less any outstanding policy loans, or a higher value, as determined by a qualified valuator. If the cash surrender value exceeds the cost base of the policy, you must include the difference in your income.
- If you would like to retain ownership of an existing life insurance policy, you can name a charity as the beneficiary of the policy. The charity will receive the death benefit proceeds upon your death, and a tax receipt for the full amount of the insurance proceeds will be issued to your estate.

Let's look at an example of a *planning opportunity*. A father owns shares in a small-business corporation and wishes to gift the shares to the children by will and eliminate having to pay capital gains taxes on the growth in the shares at death. Assuming that when the father passes away, the taxable capital gains reportable on the deemed disposition are $600,000 and tax owing on this amount is $262,200 (43.7 percent). To address the tax liability, he takes out a life insurance policy for $600,000 payable to his estate. He includes a provision in his will to donate the life insurance proceeds to the charity and also a clause directing his executor to make any election under the act to reduce taxes.

The payment to the charity will be considered a donation in the year of death and the tax receipt issued by the charity will qualify for a tax credit. The end result is that the tax liability on the shares is completely offset by the tax credit. Since ownership of the policy stays with the life insured, premiums paid during the life of the policy on death do not themselves qualify for the charitable tax credit. Yet they are, typically, a small price to pay when compared to the estate preservation achieved.

The above strategy ensures that the amount of life insurance proceeds gifted to the charity will qualify for a tax receipt. It also allows the donor to maintain control of the policy since the donor remains its owner. We should emphasize that it would require less life insurance to simply pay the taxes owing at death as compared to using the proceeds for charitable donation to eliminate the tax liability. Also, by making the estate the payee, the policy proceeds are subject to probate fees, as well as to claims of creditors of the estate.

In summary, by incorporating charitable giving into a comprehensive estate plan, your assets can benefit causes you care about. In turn, this can fulfill your philanthropic objectives while still being personally rewarding. Ensuring your intentions are satisfied requires more than just writing a cheque to your favorite cause. With proper planning, your generosity can go further with an impact beyond your expectations!

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