

## GUIDELINES ON GIFTS OF LIFE INSURANCE TO CHARITABLE INSTITUTIONS

These Guidelines have been prepared for use by state insurance department personnel who may be presented with questions or concerns regarding charitable gifts of life insurance. Of course, each state's laws on the issues discussed may differ, and the following discussion should be read with that in mind.

Q. What is meant by a gift of life insurance?

A. As a general principle, the gift of a life insurance policy to any recipient, whether such recipient is a charity or other third party, involves the same considerations and characteristics as a gift of any other property owned by the donor. Once the transaction is made, the ownership of the policy and all ownership rights under the policy, including the ability to change the beneficiary, are forever transferred from the donor to the recipient.

Q. What is meant by "charitable institutions?"

A. Charitable institutions are typically non-profit, tax-exempt organizations such as corporations or foundations organized and operated exclusively for religious, charitable, scientific, literary or educational purposes or to foster amateur sports or for the prevention of cruelty to children or animals.

Q. How is a gift of life insurance to a charity accomplished?

A. A gift of life insurance to a charity is generally accomplished in one of two ways, although there are varying alternatives within these two categories. The gift may be either of an existing policy, in the form of an irrevocable assignment to the charity, or it may be the purchase of a new policy by the insured, or with the consent of the insured, by the charity on the life of the insured, to the benefit of the charity.

Q. Why has there been an increased interest and attention focused on gifts of life insurance to charitable institutions?

A. This stems primarily from a private letter ruling issued by the Internal Revenue Service dated December 6, 1990 which indicated that federal income, gift and estate tax charitable deductions may not be allowed for gifts of life insurance to charities if the law in the donor's state did not recognize that charities have an insurable interest in the life of their donors. The ruling was based on the IRS's interpretation of New York law. Following an amendment made to New York law which specifically authorized insureds to transfer life insurance policies to charities, the IRS issued another letter ruling on November 27, 1991 revoking its earlier ruling. As a result of the revocation, much of the concern over charitable giving of life insurance has subsided.

Q. What is insurable interest?

A. Insurable interest can generally be described as an interest on the part of the applicant or owner of the policy in the continuance of the life of the insured. Everyone has an insurable interest in his or her own life and where the applicant is the insured, he or she can generally make the proceeds payable to whomever he or she wants, including a favorite charity. Where someone other than the insured is the applicant, insurable interest is typically based on a family relationship or a reasonable expectation of deriving financial or economic benefits from the continuance of the insured's life. Some states require beneficiaries to have an insurable interest in the insured. For life insurance to be enforceable, an insurable interest must exist at the time the policy is being applied for.

Q. How is the insurable interest requirement met in the context of gifts of life insurance to charitable institutions?

A. The statutory definition of insurable interest in many states specifically includes charities. In other states, charities who have an ongoing relationship with a donor may qualify under the general definition of insurable interest by demonstrating an expectation of benefit or advantage from the continuance of the life of the insured as a result of the insured's previous donation patterns, whether they be of money, other gifts or volunteer time. Other state statutes simply authorize charities to own or purchase life insurance on an insured who consents to the ownership or purchase of the insurance. The primary protection against abuse in the charitable ownership of life insurance is the requirement that the insured consent to the ownership. Many state laws require that consent to be in writing.

- Q. What other considerations are involved?
- A. There are various considerations which may help the donor determine the method he or she should use to make a gift of life insurance to a charity. Among these is whether the assignment of an existing policy would exclude from the donor's estate insurance coverage needed for more immediate family or business needs. The donor's state of health and ability to obtain other coverage should also be considered. The type of coverage in force and/or being considered for purchase may also be of significance. In that the donation may be made as part of a donor's estate or tax plan or have varying tax ramifications depending on how the transaction is structured, the donor should seek the advice of a tax expert in connection with any transaction of this nature.

The prospective donor may well find it entirely appropriate to ascertain the longevity of the charitable institution to which he or she is considering making a donation. The length of time which the charity has been in existence and its avowed goals regarding its own future activities could be significant in determining whether or not the charity will still be a viable institution when the life insurance benefit is paid.

- Q. If a state contemplates statutory or regulatory language to clarify the existence of an insurable interest in charitable organizations, what are the main items that should be considered for inclusion in the statute or rule?
- A.
1. Its purpose should be to acknowledge the existence of the insurable interest in the charity and to clarify how the law applies to charitable interest in life insurance and annuities;
  2. It should clearly state that it does not abridge or limit the insurable interest currently existing in common law or by statute;
  3. It should make clear that any specific requirements for an insurable interest to exist (e.g., written consent of the insured) are to be applicable only to insurance applied for and assignments made subsequent to enactment or promulgation of the law or rule; and
  4. It should define "nonprofit organization" to include charitable, religious, scientific, literary, educational or other legitimate institutions or entities, reasonably anticipated to be the genuine object of a donor's charitable intent. (This would include institutions or entities described in the Internal Revenue Code Sections 170, 501, 2055 and 2522).

- Q. What are some examples of statutory language states have used to respond to concerns over charitable ownership of life insurance?
- A. Two examples of statutory responses to such concerns are Colorado House Bill 1031 enacted in 1992 adding Section 114 to Article 7 of Title 10, Colorado revised statutes and Tennessee Senate Bill No. 2336, also enacted in 1992 adding Section \_\_\_ to Title 56, Chapter 7, Part 3 of the Tennessee Code Annotated.

The Colorado Law provides:

Notwithstanding any other provision of law, any organization that meets the requirements of Section 170(c) of the Federal "Internal Revenue Code of 1986," as amended, may own or purchase life insurance of an insured who gives written consent to the ownership or purchase of that insurance. The provisions of this section do not limit or abridge any insurable interest or right to insure now existing at common law or by statute, shall be construed liberally to sustain the existence of an insurable interest, and shall stand as a declaration of existing law applicable to all life insurance policies whenever issued, in existence on or after the effective date of this section.

The Tennessee Law provides:

If an organization described in either Section 501(c)(3) or Section 170(c) of the Internal Revenue Code of 1986, as amended, purchases or receives by assignment, before, on or after the effective date of this section, life insurance on an insured who consents to the purchase or assignment, the organization is deemed to have had an insurable interest in the insured person's life on the date of purchase or assignment. This section does not limit or abridge any insurable interest now existing at common law or by statute.

Citations to statutory provisions of other states dealing with charitable ownership of life insurance may be obtained by contacting the NAIC Legal Department.

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*Chronological Summary of Actions (all references are to the Proceedings of the NAIC).*

*1993 Proc. 18, 136, 801, 804, 805-807 (adopted).*