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Life Insurance as a Charitable Planning Tool: Part 2

This second part of a two-part commentary suggests additional planning strategies, examines the effect of state law, and explains how to handle troublesome transactions.

Innovative strategies

Creating a DAG (Director's Amplified Gift). Suppose, in lieu of all or a portion of a director's fee, one or more members of a company's board of directors request that the corporation make a contribution to a specified charity. That gift would be reportable as income by the director. It would also be considered a gift by the director to the charity and would be deductible. Now, suppose that no money was ever owed to the director but the corporation nevertheless made a gift to charity in the director's name. The corporation's gift to the charity would be income tax-free to the director and deductible by the corporation.

Assume that we enhance this concept and call it a DAG, or Director's Amplified Gift. The corporation would allow each of its directors to select one or more charities. The corporation would purchase a limited pay life insurance policy on each director's life. The policy would be owned by and payable to the corporation. The cash values would therefore be available to the business for an emergency or opportunity.

At the death of a director, the corporation would receive the death proceeds income tax-free (except for any alternative minimum tax (AMT) imposed on "large" corporations). After the corporation receives the policy proceeds, it pays the promised amount to the charity selected by the director. The corporation can take a charitable deduction for the payment, so that if the promise was to pay $1 million, and the policy proceeds are $1 million, the corporation can use its income tax savings to pay out much more than $1 million—or it can pay out $1 million and add any balance (after AMT) to surplus. Because a C corporation's current deduction is limited to 10% of its adjusted taxable income, the corporation may pay out the insurance proceeds over a period of years to take full advantage of the income tax deduction.

The corporation's payment of cash to the charity is income tax deductible. The directors are never subject to income or estate tax. Both the corporation and its directors receive immediate and favorable publicity. If the director leaves, the company can keep the policy, cash it in, or replace it with a term or paid-up whole life contract that will pay a reduced amount.

Director's Amplified Gift—Type II. Suppose the corporation wants an immediate income tax deduction. It could create a Type II DAG that works like this: The policy would be owned by and payable to the charity specified by the director. This would make cash values—as soon as they begin to develop—immediately available to the charity for an emergency or opportunity. The death benefit will be received income tax-free by the charity.

The donor corporation will receive an immediate income tax deduction for its annual cash contributions to the charity (subject to its annual limitation). The direc-

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tor will never be subject to income taxation, and no portion of the policy proceeds will be included in the director's estate. Both the corporation and the director receive immediate and favorable publicity. The charity can keep the policy in force until the director's death, cash it in, or replace it with term insurance or a paid-up whole life policy with a reduced death benefit.

Under a variation on this theme, the charity owns and receives the policy proceeds but the premium check paid by the corporation is treated as income to the director. In this scenario, the director-donor reports income and then deducts payments made by the corporation to the charity.

Using life insurance to perpetuate the charity's income stream in a charitable lead trust. A charitable lead trust (CLT) can be established during the donor's lifetime or at the donor's death. In a traditional CLT, the trust pays an annuity (liquidation of principal and interest over time on a fixed or variable basis) to one or more specified charities for a fixed number of years. At the end of that term, the trust pays the then remaining principal—if any—(together with any income earned beyond the amount payable to charity and any growth in trust assets) to noncharitable remaindermen selected by donor.

The problem with the traditional CLT—from the charity's perspective—is that the annuity eventually runs out. To help solve this problem, the charity uses a small portion of each year's annuity from the trust to purchase insurance on the life of the donor and/or the donor's spouse. At the donor's/donor's spouse's death, the charity receives sufficient insurance proceeds to replace all or a portion of the income stream it was enjoying and to perpetuate the annuity.

At the same time, the donor gives his/her children/grandchildren (or trust or FLP or LLC in which they hold an interest) sufficient cash to purchase insurance on the donor's/donor's spouse's life. At the donor's death, the children don't have to wait until the charity's annuity ends to achieve financial security or to purchase assets from donor's estate. So the charity receives a sizable annuity for many years from the CLT, and then the annuity is eventually replaced by insurance proceeds on the life of the donor/donor's spouse. The donor's estate receives a significant federal estate tax deduction that can shelter a substantial amount of wealth.

Key person protection. A charity can purchase insurance on the life of a major regular contributor, a particularly valuable board member, or a key employee to provide an "Economic Shock Absorber" to the charity to compensate for that person's loss.

Using life insurance inside a charitable remainder trust. It is permissible to purchase and maintain life insurance inside a charitable remainder unitrust (CRUT). For instance, suppose Jo-Ann makes annual contributions to a CRUT that will last for her life and the life of her handsome spouse. The CRUT purchases a policy on her life. When she dies, insurance proceeds are paid to the trust and "swell" the value of the trust so that at its next valuation, the trust has a much higher value than previously. In other words, her husband's annual unitrust payments will be based on a much larger amount and so will be significantly greater than if the policy had not been purchased.

For example, assume Greg and Tiana create a CRUT for United Cerebral Palsey. The trust provides both spouses an annuity for life equal to 6% of the trust's value, as revalued each year. If Greg is insured for $1 million by the trust, the size of the trust will "balloon" by $1 million at his death. Although Tiana's annuity percentage payout remains the same, 6%, her actual annuity payment increases the first year of revaluation by $60,000, 6% of $1 million! Of course, the charity also benefits because it receives the remainder interest in the $1 million. If the donor lives to a normal retirement age, the independent trustee[1] of the CRUT can surrender the policy and invest the proceeds to increase the annuity available for payout. The donor or others could make continuing contributions to the CRUT.

In a slight twist on this theme, the IRS concluded in Ltr. Rul. 199915045 that, because the insurance contract is owned by the CRUT and is irrevocably payable for a charitable purpose, neither the existence of the policy in the trust nor the existence or exercise of the trustee's power to pay annu-

[1] A CRT loses its tax-exempt status and the donor loses his/her deduction if the CRT is considered a grantor trust. The potential problem lies in the language of Section 677(a)(3), which states that if trust income is or may be used to pay premiums on life insurance on the trust's grantor, that trust is taxed as a grantor trust—i.e., as if the grantor and not the trustee were the owner of the trust and recipient of the income and gains it produces. This problem can be prevented by providing that the trustee may not use trust income to pay premiums and must make all such payments from capital. The trust document should also require that in all respects the policy and its proceeds be used solely for charitable purposes. See Ltr. Rul. 9227017. Although it may be possible for the donor to be trustee without triggering the grantor trust rules, an independent trustee should be selected for safety.

al premiums on the policy would jeopardize the trust's tax-exempt status. The IRS ruled further that neither spouse would be taxable as owner of any portion of trust, the donor would be entitled to both income and gift tax deductions for an amount equal to the present value of the charity's remainder interest in the life insurance, and the policy and proceeds would escape inclusion in both spouses' estates.[2]

In Ltr. Rul. 199915045, the taxpayer created a CRUT for the sole benefit of his stepdaughter and specified qualified charities. The trustee, an independent bank, will pay his stepdaughter an annuity four times per year for life. She will be paid the lesser of the charitable remainder trust's (CRT's) income, or 6% of the net fair market value of the CRT's assets valued annually. A "make-up" clause provides that the unitrust amount for any year will include any amount of the trust's income in excess of the amount required to be distributed under the general rule above to the extent that the aggregate of the amounts paid in prior years was less than the aggregate of the amounts computed as 6% of the net fair market value of the trust's assets on the valuation dates. When the stepdaughter dies, the trust assets will pass to specified qualified charities.

Here, the taxpayer purchased a single premium policy on his wife's life and then transferred the policy to the trust and made the trust absolute owner and beneficiary. With respect to that (and other) life insurance, the CRUT's trust document provides that the trustee will have the power "to sell appreciated assets contributed to or owned by the trust and may use the proceeds, or use other assets of the trust, to acquire and hold insurance on the life of wife and to pay the premiums on such insurance and to exercise all rights of an owner of such insurance, including the right to surrender the insurance or allow it to lapse, provided that the premiums paid on the insurance, whether payable from net income or taxable income of the trust, shall be charged to the trust's principal account and any proceeds paid on the insurance upon the death of the insured, any dividends paid on the insurance during the life of the insured, any withdrawals made from the insurance during the life of the insured and any amount paid on the surrender of the insurance during the life of the insured shall be credited to the trust's principal account, and no part of any such receipt shall be credited to the trust's net income account notwithstanding any statute, rule, or convention to the contrary."

State law here had no statutory provision concerning whether the trust's payment of premiums on life insurance policies should be charged to principal or income, or concerning whether any amounts received by a trust on account of life insurance policies should be allocated to principal or income. Any state law that would allocate to income a portion of the proceeds received from the sale or other disposition of under-productive assets (such as a life insurance contract) is subject to the provisions of the CRUT's governing instrument.

To be "qualified," a CRT must both satisfy the definition of, and function exclusively as, a charitable remainder trust from inception. Neither the grantor nor any other person can be considered the "owner" of the entire trust for income tax purposes, or the trust fails to qualify. Fortunately, for purposes of this test, neither the grantor nor the grantor's spouse is considered the owner merely because the grantor or grantor's spouse is named as recipient of the annuity or unitrust amount. But they will be treated as the owner of any portion of a trust whose income (without the approval or consent of any adverse party) is, or in the discretion of the grantor or a non-adverse party, or both, may be applied to the payment of premiums on policies of insurance on the life of the grantor or the grantor's spouse. Fortunately, there is a safe harbor exception: Policies of insurance owned by a CRT and irrevocably payable solely for a charitable purpose will not make the grantor an owner.

Under the facts of Ltr. Rul. 199915045, the taxpayer proposed to transfer an insurance policy on his wife's life to the trust. It is important that the terms of CRUT's governing instrument provided that any amount received by the trust from the policy on the wife's life, (regardless of whether received during her lifetime or at her death) will be allocated to the principal rather than to the income of the trust.

The trust in the ruling is considered an "income exception" unitrust. That means the unitrust amount payable to the stepdaughter (the noncharitable beneficiary) is limited to the trust's income if such income is less than the fixed percentage of the net value of the trust's assets. Because amounts received from the insurance policy on the wife's life will not be allocated to income, these amounts will not be used in computing the amount of the trust's income. In other words, they will not be used in determining the income limitation on the unitrust

[2] Remainder interest computations can be performed on NumberCruncher Software (610-924-0515).

amount payable to stepdaughter, the noncharitable beneficiary. Instead, amounts received from an insurance policy on the wife's life *will be allocated to the trust's* principal and will become part of the remainder that is payable to qualified charitable organizations.

The IRS ruled that because all the insurance proceeds would be paid for a charitable purpose, the existence or exercise, if necessary, *of the trustee's power to pay annual* premiums on the insurance policy on the wife's life does not cause either spouse to be treated as owner of all or any portion of the trust. Nor does Section 2035 apply because the policy that the husband transferred to the trust was not on his life. So even if he dies within three years of the transfer, the proceeds would not be brought back into his estate. Similarly, because the wife never had any incidents of ownership, Section 2035 should not apply even if she dies within three years of her husband's transfer.

Essential tax knowledge

Impact of state law. In any transaction involving life insurance, even when a charity is involved, it is essential to consider state law in general and "insurable interest" law in particular. Insurable interest refers to and encompasses the public policy requirement imposed by state law[3] (as well as by the insurers) that there must exist a relationship between the insured and the policy owner such that the policy owner has a strong interest in the continuing life of the insured and is insuring to compensate for potential loss rather than merely making a wagering contract. Insurable interest is essentially "love or affection between related persons and lawful economic interest in the continuation of the insured's life or potential for loss at insured's death."[4]

In Ltr. Rul. 9110016, the IRS denied income, gift, and estate tax charitable deductions because under state (New York) law, the charity didn't have an insurable interest in the donor's life. The

[3] Usually, but not always, only the policy owner's state law governs. For example, if a charity located in Pennsylvania purchases a policy on the life of a donor residing in Montana, the insurable interest rules for Pennsylvania (the location of the policy owner) must be met. If one party purchases a policy but the ownership is immediately transferred to another party, the insurance company may later attempt to void the contract if the insurable interest rules for either owner are in any way not met. In the example above, if the Montana donor purchases the policy on his own life and then immediately transfers the policy to the Pennsylvania charity, the policy could be found void if Pennsylvania's insurable interest laws are not closely followed. Technically, Montana's laws should apply since the policy was issued in Montana, but the insurance company can assert that Pennsylvania's laws should apply since the policy was only temporarily owned by a Montana resident in anticipation of transferring it to Pennsylvania. In such a case, it is best to check and meet both states' requirements if possible.

problem was that the donor's estate could sue the charity for a recovery of the insurance proceeds on the ground that the charity had no insurable interest in the life of the donor. Because the estate could void the transfer, that possibility was considered a retention by the insured's estate of the right to name the beneficiary of the policy, a violation of the partial interest rule of Code Section 170. This ruling was later revoked by Ltr. Rul. 9147040 after New York law was amended.

Relevant state law must always be considered where the charity is to be the original owner of the contract. Typically, an insurable interest is relevant only at the inception of the contract, and in most states, once there is insurable interest, a later transfer to a charity will not be a problem.[5] Generally, the laws of the state where the policy was originally purchased govern that policy for its duration, even if the policy is then donated to an out-of-state charity.

There are no insurable interest issues with respect to naming the charity as a mere beneficiary of life insurance proceeds. Nevertheless, because the charity must be named both owner and beneficiary in order for the donor to obtain a charitable deduction, the insurable interest issue must always be considered.

In many states (including New York), charities are not allowed to directly acquire insurance on someone's life unless the charity has an insurable interest (e.g., employee of charity).[6] The longer the policy is owned by the insured, the less troublesome the insurable interest problem usually is.

There is another potential insurable interest problem. An insurance company could refuse to pay proceeds if, under state law, the charity had no insurable interest in the continuing life of the insured. Alternatively, if the proceeds have already been paid, the estate's executor could sue to recover the proceeds from the charity.

Even where insurable interest exists, if the insured purchases the policy and dies within three years of its transfer to a charity, the death proceeds are includable in the estate of the insured under Code Section 2035(a), and the decedent's personal representative (absent exoneration in the will) has a right of reimbursement for the estate tax generated by that inclusion. This result emphasizes the importance of co-ordination of charitable planning and life insurance with the decedent's will, and highlights the need to expressly provide that property qualifying for the charitable deduction inside or outside the probate estate will not be charged with federal or state death taxes. It further suggests that whenever possible, the charity should be the original applicant and owner.[7]

Problematic transactions

There are certain life insurance/-charitable transactions that are, by definition, troublesome. These include the following.

Naming a charity as irrevocable beneficiary. One mistake planners should never allow a client to make is naming a charity as the irrevocable beneficiary of life insurance. The client receives no income tax deduction either for the policy or for the payment of future premiums. He or she has no ability to change the policy's beneficiary—even to another charity. And policy proceeds will be federal estate tax includable.

Contribution of policy subject to a loan. The donation of a life insurance contract subject to a loan of any size will result in a tax disaster. If the policy has a substantial loan against it when contributed, the transfer will be considered a "bargain sale." This means that the transfer is in part a donation of the policy and in part a sale of the policy. The sale portion reflects the fact that the donor will no longer be called upon to repay the policy loan and has been relieved of that obligation. In other words, it's as if part of the policy had been donated, and part of the policy—in the amount of the loan that the donor put in his pocket—had been sold to the charity. The donor must report gain (if there is any) on the sale portion, in the year of the gift.

Second, the donor is treated as having then received an amount equal to the loan portion. The donor must therefore recognize gain equal to the amount of the loan minus the adjusted basis allo-

[4] In Re Gibbons' Estate, 331 Pa. 36 (1938). Insurable interest is a relationship between the policy owner and the insured which was designed to assure that the insurance contract was something other than a form of gambling and speculation on a person's life. It was designed to reduce the possibility that the purchaser of the policy would have an incentive for hastening the maturity of the policy by murdering the insured. Typically, spouses are deemed to have an insurable interest on each other's lives, and companies have an insurable interest on truly key employees. For more on insurable interest, see *Tools and Techniques of Life Insurance Planning* and *Tools and Techniques of Charitable Planning* (800-543-0874).

[5] See Schlesinger, "Charitable Giving: Using Life Insurance in Charitable Planning," 25 ETPL 387 (Oct. 1998).

[6] All but five states (Colorado, Illinois, Michigan, Wisconsin, and Wyoming) have enacted legislation on this issue. Arizona, Connecticut, Florida, Minnesota, and Pennsylvania all grant charities an insurable interest in the lives of donors. Other states have laws permitting an executor to recover the proceeds if a contract was issued to a party who does not have an insurable interest in the insured (Arizona, New Jersey, and New York).

[7] See Millard, "Using Life Insurance to Fund a Donor's Charitable Gifts," 22 ETPL 290 (Sept./Oct. 1995).

cable to the sale.[8] This gain is ordinary income.

Third, there is a possible issue of "prohibited self-dealing" with respect to contributions of policies subject to loans: A gift of a policy subject to a loan—if the gift is made to a private foundation—could trigger a self-dealing problem[9] if the donor is a "disqualified person" and the loan was made within the ten-year period ending on the date of the gift. Because the donor is relieved of the obligation to repay the loan or to pay interest on it, the gift can be problematic.[10] The private foundation[11] rule on self-dealing also applies to gifts made to charitable remainder annuity trusts and charitable remainder unitrusts.

Finally, no matter how small the loan is (or even if it is paid off by the donor instantly after the contribution), under the charitable split-dollar rules discussed below, the donor's deduction for both the gift of the policy itself and any subsequently paid premiums will be lost forever if there is a loan against the policy at the time it is contributed! And if the trustee of a CRT borrows against the policy and invests the borrowed funds in new income-producing property, the income generated is considered debt-financed income.[12]

Unrelated business taxable income. If a charity cashes in a policy, it will generally pay no tax because of its tax exemption. Even *if a charity borrows against a life* insurance policy to purchase land or a building which it will use, or even to pay salaries or meet some other emergency or opportunity, there's no problem. The charity will not incur any income tax. There's never a problem as long as the borrowing is for a purpose inherent to the performance of the charity's exempt purpose. But, as noted in the prior paragraph, if the CRT or private foundation uses policy cash values or uses the policy as collateral to finance and purchase a new income-producing investment, the income produced by that debt financing may be considered UBTI, or unrelated business taxable income. A charity is generally exempt from *income tax under Section 501,* but if an organization has income from "any unrelated trade or business regularly carried on by it," the net income (income less directly related deductions) produced is taxable, generally at corporate rates.[13]

Also, beware of situations where a policy is placed in a CRT that must borrow on the policy's cash value or from some other source to pay premiums.[14] A policy loan can result in adverse tax treatment if the loan is considered "acquisition indebtedness." But as long as the policy is a sound investment, the trust's loan should not be treated as a prohibited payment to a beneficiary in violation of the rule prohibiting payments other than the sanctioned annuity amounts.

Transactions that limit the charity's investment discretion. Perhaps the least understood and least honored of all the rules planners must consider when dealing with life insurance and charitable entities involve the potential problems created if the arrangement—no matter what it's called or how it's arranged—limits the investment discretion of the charity or charitable trust. If the charity loses this discretion, there has been a violation of either the letter or the spirit of the rules under Sections 4941 to 4945.[15]

Transactions that result in the donor receiving direct or indirect gain. Planners must be exceptionally sensitive to the spirit of the laws dealing with "private inurement and private benefit." In a nutshell, *if the transaction involves the* economic enrichment of someone other than the charity or the charitable trust, suspect that there may be problems.

Jeopardy investment rules. Charities and the trustees of CRTs have a fiduciary responsibility to invest their assets wisely. There will be problems if the insurance policy at the date of purchase is such a poor investment that it jeopardizes the charity's exempt purposes. Section 508(e) requires a CRT to specifically prohibit such an investment. A trustee must exercise ordinary business care and prudence, and must consider the short- and long-term goals and needs of the trust, as well as the facts and circumstances.[16] However, life insurance should not generally be considered a jeopardy investment as long as the death benefit will be greater than *the sum of the net premiums.* But the trustee or the charity must give both initial and constant attention to the soundness of the insurer and the appropriateness of the coverage for the purpose.[17]

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[8] Reg. 1.170A-4(d), Example 6.

[9] Section 4941(d)(2)(A).

[10] See Rev. Rul. 80-132, 1980-1 CB 255.

[11] For information on life insurance and private foundations, see McCoy and Miree, *Family Foundation Handbook*, Panel Publishers (www.panelpublishers.com); *Tax Planning With Life Insurance*, RIA (800-950-3055), and *Tools and Techniques of Charitable Planning* (800-543-0874).

[12] Siskin Memorial Foundation, Inc., 790 F.2d 480, 57 AFTR2d 86-1409 (CA-6, 1986).

[13] *Id.*; Ltr. Rul. 8040036; TAM 8042012.

[14] See Reg. 1.514(c)-1(a)(2), Example 3.

[15] See the extensive discussion of this issue in *Tools and Techniques of Charitable Planning* (800-543-0874).

[16] See Section 4944.

[17] See Ltr. Rul. 8745013 and Rev. Rul. 80-133, 1980-1 CB 258.

If it's clear from the outset that the policy in question makes no economic sense, the jeopardy investment problem will arise. For example, if a client donates a policy that is so encumbered that the net amount that the charity, trust, or foundation could receive in proceeds could never match or exceed the cost of paying premiums and interest, the contribution would be considered a jeopardy investment.[18] Therefore, trust instruments should restrict a trustee from investing in a manner that will result in the realization of less than a "reasonable amount" of income. For instance, if the trust requires the purchase of life insurance, this rule may be violated.[19] But if the trustee is given broad investment discretion, the purchase of life insurance should not violate this rule.[20]

Charitable split-dollar rules[21]

Charitable split-dollar and charitable reverse split-dollar were schemes by which promoters convinced their clients to take a deduction for checks written to charity, even though the money passed quickly through the black box of life insurance and made a circle through the charity and almost immediately back to trusts the clients had set up for their children and grandchildren.[22] In other words, these schemes were only incidentally about benefitting charity and were mainly about generating a deduction and shifting gift tax-free wealth to the "donor's" children and grandchildren through newly purchased life insurance. Congress enacted the following rules to thwart and penalize such abusive tactics.

Denial of deduction. No income or gift tax charitable contribution deduction is allowed for a transfer to or for the use of a charitable organization if, in connection with the transfer, (1) the organization directly or indirectly pays, or has previously paid, any premium on any "personal benefit contract" with respect to the transferor, or (2) there is an understanding or expectation that any person will directly or indirectly pay any premium on any "personal benefit contract" with respect to the transferor.[23] (An organization is considered as indirectly paying premiums if, for example, another person pays premiums on its behalf.)

Personal benefit contract defined. The term "personal benefit contract" means, with respect to the transferor, any life insurance, annuity, or endowment contract, if any direct or indirect beneficiary under the contract is the transferor, any member of the transferor's family, or any other person (other than a qualified charity) designated by the transferor. For example, a trust having a direct or indirect beneficiary who is the transferor or any member of the transferor's family would be fatal, as would an entity that is controlled by the transferor or any member of the transferor's family. (The term "a beneficiary under the contract" includes any beneficiary under any side agreement relating to the contract.) What's really important is for planners to understand not only the general rule but also the exceptions.

Exception if charity is named sole beneficiary. If a transferor contributes a life insurance contract to a qualified charity and names one or more qualified charities as the sole beneficiaries, generally, the deduction denial rule will not apply. Beware; there is an exception to this exception: As noted above in the discussion of loans at the time a policy is contributed to charity, the "sole beneficiary" exception does not provide protection if there is an outstanding loan under the contract upon the transfer of the contract. The transferor will be considered a beneficiary if, at the time the policy is transferred to the charity, there is a loan outstanding. Even if the encumbered policy also has other direct or indirect beneficiaries (persons who are not the transferor or a family member, or designated by the transferor), it will still be a personal benefit contract and fail to be protected under the "sole beneficiary" safe harbor. There is no de minimis rule, so that a loan of any size on the date the policy

[18] See Rev. Rul. 80-133, *supra* note 17.

[19] See Reg. 1.664-1(a)(3).

[20] Ltr. Rul. 8745013.

[21] For articles on problematic schemes of the past (that will be useful guidelines to test the marketing arrangements of the future), see Horowitz, Scope, and Goldis, "The Myths of Charitable Split Dollar and Charitable Pension," 49 J. Am. Soc'y of CLU & ChFC 98 (Sept. 1995), in which the authors address the subject of charitable reverse split-dollar. See also the following excellent and well-reasoned discussions: Freeman, "Charitable Reverse Split Dollar: Bonanza or Booby Trap?," J. Gift Planning (2nd quarter, 1998) (317-269-6274); Scroggin and Flemming, "A Gift With Strings Attached?," Financial Planning Magazine, p. 2 (May 1998); Scroggin and Flemming, "One Gift, Many Unhappy Returns," Financial Planning Magazine (June 1998); and Billitteri and Stehle, "Brilliant Deduction?," 10 The Chronicle of Philanthropy 24 (8/13/98). This last article is available to subscribers of Leimberg Information Services, Inc., at http://philanthropy.com/premium/articles/v10/i20/20002401.htm.

[22] http://members.aol.com/CRTrust/CSD.html (Vaughn Henry's Web Site); http://members.aol.com/CRTrust/CSD2.html (Vaughn Henry's Web Site); http://www.ncpg.org/charitablepaper.html (NCPG, "Position Paper); http://home.isoft.com/archives/aba-otl.html (ABA archive); http://www.deathandtaxes.com/csd.htm (JJMacNab); http://www.leimberg.com (Leimberg Associates, Inc.); "Split Dollar Life Insurance: Rip, Split, or Tear?," 31 *U. Miami Heckerling Inst. on Est. Plan.*, ch. 11; and audio tape discussion between Michael Goldstein and Stephan R. Leimberg, Manulife Financial (available by calling Advanced Markets at 617-854-4323).

[23] See Section 170(f)(10).

is donated will forever bar a deduction, not only of the value of the policy itself but of all future premium payments!

Exception for charity's employees. If the policy is part of a bona fide fringe benefit plan covering the employees of the charity, it is exempted from the provisions of the law.

Exception for charitable gift annuity. Even though a person will be considered as an indirect beneficiary under a contract if, for example, the person receives or will receive any economic benefit as a result of amounts paid under or with respect to the contract, a protective exception applies in the case of a charitable gift annuity. Accordingly, a person who benefits exclusively under a bona fide charitable gift annuity will not be considered an indirect beneficiary.

Exception for life insurance in CRTs. A person who is a recipient of an annuity or unitrust amount paid by a CRT is not considered an indirect beneficiary under a life insurance policy purchased by the trust, if the CRT possesses all the incidents of ownership under the contract, and is entitled to all the payments under the contract. A life insurance, endowment, or annuity contract is not considered a personal benefit contract merely because a recipient of an annuity or unitrust amount paid by a CRT uses his or her annuity to buy a life insurance, endowment or annuity contract, and a beneficiary under the contract is the recipient, a member of his or her family, or another person he or she designates.

Excise tax. An excise tax is imposed on a charity in the amount of the premiums it pays on any life insurance, annuity, or endowment contract, if the payment of premiums on the contract is in connection with a transfer for which a deduction is not allowable under the deduction denial rule. Payments are treated as made by the charity, if they are made by any other person pursuant to an understanding or expectation of payment.

The excise tax does not apply if all the direct and indirect beneficiaries under the contract (including any related side agreement) are qualified charities.

Reporting. A charity must report each year the amount of premiums that is paid during the year and that is subject to the excise tax imposed under the statutory provision. The charity must also note the name and taxpayer identification number of each beneficiary (including the beneficiary under any side agreement) under the contract to which the premiums relate, as well as other information required by the Secretary of the Treasury.

Conclusion

Charitable planning with life insurance should first and foremost be motivated by a strong desire to help others. Life insurance is an incredible tool that can significantly enhance a client's ability to make a meaningful and lasting gift to charity. But planners must approach this tool as a craftsperson approaches fire.

The IRS will not only strictly impose a set of complex, interconnected, and labyrinthine laws in order to achieve congressional objectives of preventing abuse and protecting charitable interests; but the IRS will also look beyond the strict letter of the law to congressional intent—i.e., that a charity or charitable trustee must have unfettered free will and objectivity so that investment decisions cannot be subverted and that charitable dollars not be diverted—directly or indirectly—or used unwisely—to benefit someone other than a charity or its intended beneficiaries. States' Attorneys General will carefully scrutinize transactions between charities and financial product providers. Life insurance and other financial products play an extremely important role in charitable planning—but must not be abused, misused, or unfairly and improperly used. Big brother is—no doubt—watching.

The ultimate test of the appropriateness of life insurance is simple. One must merely ascertain the answers to these four questions: Did (or will) the donor (or the donor's family or family trust) receive—directly or indirectly—anything of economic value (beyond a relatively insubstantial and insignificant value) in return from the charity for the check he or she wrote or the property he or she donated? Was (and is) the life insurance needed by the charity and appropriate in amount and type? Did the charity pay more than a reasonable amount for what it received? Does this investment limit or subvert the charity's investment discretion? ■