Vancouver Pacific Financial Group

Charitable Insurance

Is it one of your desires to create a charitable gift through regular accumulation, and have that gift donated at death?

Many people are unaware that:

- They can obtain a tax deduction today for certain gifts to be donated later at death!
- They can create a much larger gift through the purchase of insurance than they can by simply saving money in non-registered accounts!

Any individual can purchase a Life Insurance policy with the intention of having the proceeds used as a charitable donation. If this is done through the individual's will, then the amount of the donation is subject to the 100% of income rule in the final tax return, is not creditor proof and is subject to probate fees. If the charity is named as beneficiary and the policy is assigned to the charity when it is issued then each premium paid is treated as a donation and develops a tax credit. The proceeds are creditor proof and not subject to probate fees.

Any form of life insurance qualifies, but if the individual has significant income and wants to prepay the policy then a Universal Life plan makes excellent sense. This account value is paid out to the charity in addition to the basic face amount on death which enhances the amount of the gift. As the charity is not concerned about the exempt status of the policy, the amount of funding is only limited to the percent of income rules for the tax credit on deposits.

Canadians may donate up to a maximum of 75% of taxable income in any one year to qualify for charitable donation tax credits. Deposit and payment duration of the policy should be selected so as to fall within this limitation. Over payments may be carried forward for up to 5 years. The 1996 federal budget increased the limit on charitable donations to 100% of an individual's net income in the year of death and in the immediately preceding taxation year. The 75% limit remains in effect for other years except where appreciated capital property is gifted. In this case, the donation limit equals 100% of the net income that arises as a consequence of the gift.

Donations received by charities must be spent according to a set of rules known as "Disbursement Quotas" which dictate what proportion of the preceding year's donations must be spent by the charity for charitable purposes in the current year. The actual proportion depends on the category of the charity. Charitable Organizations and Public Foundations must disburse 80% of their income and Private Foundations must disburse 100%. This places a limitation on the gifting of premiums for a life policy which are not available for disbursement until death of the donor. Care should be taken to review this aspect with all parties when considering a Charitable Insurance Plan.

*Information courtesy of Transamerica Life Insurance Company of Canada E. & O. E.

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There is a way around this Disbursement Quota. If the donor stipulates that the charity may not disburse the donation for ten years then the donation is not added to the calculation for the disbursement quota, but the donor still gets a receipt in the year the donation was made. Therefore, in this case, the donor must stipulate that the charity may not disburse the donated premiums, or substituted property, until TEN YEARS after the LAST premium was paid on the policy. This is known as the "Ten Year Rule". Refer to paragraphs 6 through 8 of Revenue Canada's interpretation Bulletin IT-244R2 for more details.

Investment income is not included in a charity's disbursement quota calculations. This allows the charity to be indifferent to owning a non-exempt policy.

POLICY OWNERSHIP & BENEFICIARY CONSIDERATIONS

There are a number of options available and each has a valid use depending on the objectives of the donor.

A simple way of setting this up so as to get the annual tax credits for the premiums is to establish the charity as the owner and beneficiary of the policy. The donor, who is the life insured, then gifts a sum equal to the annual premiums to the charity (mindful of the 75% of taxable income rule) who then pays the premiums to the insurer. The gifted premium must fall within the charity's 20% quota of undisbursed gifts (for public foundations).

A common variation of this method is to set up the policy on the donor's life with his/her ownership (or use an existing policy set up in that way) and then make an absolute assignment of the policy to the charity. The donor then continues to pay premiums to the insurer and receives a tax receipt from the charity once proof of payment of the premium has been furnished to the charity. At the date of assignment, the liquid value of the policy, plus the premium for that year will be eligible for treatment as a charitable donation.

For maximum flexibility, the policy can be owned by the donor and the charity named as beneficiary. An advantage is that the donor retains complete control of the policy and can change his/her mind; cash it in, etc. A disadvantage is that premiums are ineligible for tax credit.

A variation on this theme is to have the estate as beneficiary and the Will direct executors to pay policy proceeds to one, or more charities. In such cases, where the proceeds flow through the estate, a tax credit will be allowed (up to 100% of income) for the year of, and the year preceding, the donor's death.

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