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The anatomy of a gift of life insurance proceeds by direct designation

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An individual may donate the proceeds of a life insurance policy on their life that they own by way of a beneficiary designation in favour of a charity. The death benefit is considered to be a charitable gift by "direct designation".

This was not always the case. The 2000 Federal Budget introduced a donation tax credit for direct designations of life insurance for deaths after 1998. Prior to that it was the view of the CRA that the charity received the life insurance proceeds in the year of death by operation of contract as beneficiary under the policy and not by a transfer from a donor with charitable intent.

Gifts by direct designation are now deemed to be made by the estate at the time that the life insurance proceeds are received by the charity. If the estate qualifies as the graduated rate estate (GRE) of the deceased, a charitable donation tax credit could be claimed in any of:

- the terminal return of the deceased;
- carried back to the year prior to death of the deceased;
- in the year of the gift by the GRE or a prior year of the GRE; and,
- carried forward for 5 years in the estate if it continues.

The requirements – What's in

Under subsection 118.1(5.2) the following requirements must be met to qualify as a gift by direct designation:

- Money or a negotiable instrument must be transferred to the charity in respect of the individual's death;
- The transfer is made as a consequence of death solely because of the obligations under a life insurance policy under which the individual's life was insured;
- Immediately before death, the individual's consent would have been required to change the recipient of the transfer; and

- The transfer is made from an insurer to the charity, and that charity was, immediately before the death, neither a policyholder under the policy nor an assignee of the individual's interest under the policy.

Designating a charity as a beneficiary of a life insurance policy other than in these circumstances, will not qualify as a charitable gift.

The designation in favour of the charity can be made irrevocably and qualify under these rules (Q7 2004 CALU CRA Roundtable #2004-006551C6). The charity does not have to be the sole beneficiary - the portion of the death benefit received by the charity can qualify as a gift (#2003-018216). The policy can be a foreign policy (#2026-1089391C6 2026 CALU CRA Roundtable Q7 Scenario 4). The death benefit under a jointly owned joint first-to-die policy in respect of spouses where the charity is designated for a portion and the surviving spouse the other portion, qualifies as a gift by the deceased spouse's estate (2026 CALU Q7 Scenario 1).

What's out

Where the charity jointly owns a policy with a donor and is designated as beneficiary, there would be no gift on the death of the life insured (2026 CALU Q7 Scenario 3) since the charity was a policyholder immediately before death. Where a joint first-to-die policy in respect of spouses is owned by one spouse, even where the other spouse consented to the owner spouse designating a charity for a portion of the policy's death benefit, on the first death of the non-owner spouse, there would be no gift since the deceased spouse was not a policyholder. The owner-spouse could have changed the designation without consent of the non-owner spouse and thus consent of the deceased would not have been required prior to death (2026 CALU Q7 Scenario 2).

Gifts of a policy itself (for example, a policy owned by a deceased on the life of their spouse or child) by way of a successor owner designation would not qualify as a charitable gift since the transfer arises due to a contractual right and is not considered a charitable gift. If on the other hand, the gift of such a policy was made in a Will, this would qualify as a gift on death (#2017-0705231C6).

A corporate-owned life insurance policy should not designate a charity as beneficiary. This would result in no gift under section 110.1. The rules for direct designations only apply to individuals. In addition, there would also be no capital dividend account credit since the corporation would not receive the death benefit, the charity would. Where a corporate gift of life insurance proceeds is contemplated, the corporation should receive the death benefit proceeds and then make a gift.

In summary

Direct designations are deemed to be charitable gifts. If the specific requirements are not met – no gift. But if met, the estate donation rules provide for very flexible use of the charitable donation tax credit arising from the gift of life insurance proceeds.

FOOTNOTE:

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