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BILL ANALYSIS

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Senate Bill 702 (as enrolled)
Sponsor: Senator Philip E. Hoffman
Committee: Financial Services

Date Completed: 9-19-96

RATIONALE

Reportedly, a private letter ruling issued by the Internal Revenue Service (IRS), in 1990, has prompted some states to pass new laws or amend existing ones concerning gifts of life insurance to charities. According to some, it is an issue Michigan also should address in statute. Apparently, a gift of life insurance to a charity usually is accomplished in one of two ways, although there are varying alternatives within these two categories. The gift may be either an irrevocable assignment to the charity of an existing policy or the purchase of a new policy to the benefit of the charity; the new policy may be purchased either by the insured or by the charity on the life of the insured, with the consent of the insured (who apparently pays the premiums).

According to the National Association of Insurance Commissioners (NAIC), the IRS indicated in a private letter ruling dated December 6, 1990, 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 does 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. After the law was amended specifically to authorize an insured to transfer a life insurance policy to a charity, the IRS evidently issued another letter ruling on November 27, 1991, that revoked its earlier ruling. To avoid the possibility of having a similar ruling concerning their insurance statutes, many states reportedly have passed or are working on legislation that specifies that charities have an insurable interest in a donor if the donor consents. It has been suggested that Michigan, too, should adopt a law to allow charities to have an insurable interest in a donor.

CONTENT

The bill would amend the Insurance Code to allow a charitable organization, as described in Section 501(c)(3) of the Federal Internal Revenue Code, to have an insurable interest in the life of an individual who gave written consent to the ownership or purchase of a policy on his or her life.

Proposed MCL 500.2212

BACKGROUND

According to the NAIC, an insurable interest generally can be described as an interest on the part of the applicant or owner of the policy in the continuance of the insured's life. Presumably, everyone has an insurable interest in his or her own life, and, if the applicant is the insured, he or she usually may make the proceeds payable to whomever he or she wants, including a favorite charity. If someone other than the insured is the applicant, insurable interest typically is based on a family relationship or a reasonable expectation of deriving financial or economic benefits from the continuance of the insured's life. The NAIC reports that some states require beneficiaries to have an insurable interest in the insured. For life insurance to be enforceable, an insurable interest must exist when application for the policy is made.

Apparently, the statutory definition of "insurable interest" in many states specifically includes charities. In other states, charities that have an ongoing relationship with a donor reportedly may qualify under the general definition of insurable interest by demonstrating an expectation of benefit or advantage from the continuance of the insured's life as a result of the insured's previous donation patterns 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.

ARGUMENTS

(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)

Supporting Argument
Since Michigan's Insurance Code does not specify that a charity has or may have an insurable interest in a donor, it is possible that the IRS would interpret this omission as a prohibition against charities' owning life insurance policies on donors, and would issue a ruling concerning Michigan cases similar to the ruling based on the IRS's 1990 interpretation of New York law. If the ruling were issued, there would be less incentive for donors to make a gift of a life insurance policy to a charitable organization because the gift would not be eligible for a charitable deduction from taxes. The bill would help avoid the ruling by allowing charities to have an insurable interest in the life of a donor, yet would protect the interests of the donor by conditioning the insurable interest upon the donor's written consent.

Supporting Argument
As less money becomes available for charitable giving because of other demands on individuals' personal finances, charitable organizations are looking for creative ways to make philanthropic contributions more attractive. Both the charitable organization and the insured/donor stand to gain from the process envisioned by the bill's proponents. The charity would be the beneficiary of an insurance policy on the life of the donor, while the donor would pay the premiums on the policy (which would be owned by the charitable organization) and receive tax benefits for a charitable contribution. In addition, this arrangement would allow an interested donor's financial contributions to have a much greater impact. By paying the price of the monthly premiums, he or she could eventually be responsible for giving the charity a large, lump sum of money in the form of an insurance payout.

Opposing Argument
The bill could establish a dangerous precedent. It could take advantage of a person who was elderly, infirm, or suffering from dementia or otherwise lacking sufficient reasoning ability, or who, for various reasons, had to rely on a charity or charitable organization to provide care for him or her. A charitable organization conceivably could persuade or coerce the person into consenting to the organization's ownership of an insurance policy on his or her life. It is possible that a donor would make decisions that did not protect his or her health, welfare, and best interests, especially if the donor were being cared for by the charitable organization. Assignment of a life insurance policy's benefits to a charity by a donor is one thing. Actually putting a charity in the business of making the payments and owning a policy on a life, particularly if the charity were involved in the care provider business, could be disastrous.

In addition, mere consent on the part of a donor would not be sufficient to protect him or her from unscrupulous charitable organizations. At the very least, the bill should ensure that the donor would have some control over how the policy could be used and for what purposes the ownership was purchased.

Response: Currently, an insured can name a charitable organization as a beneficiary, so the bill would not open new doors to potential abuses. The bill merely specifies that a charitable organization would have an insurable interest in the life of an insured, in order to meet IRS requirements for premium payments (which would be made by the insured, *not* the beneficiary charitable organization) to be considered charitable contributions. Also, these policies would be subject to the same procedures as are any other insurance policies. Insurance underwriters are not likely to place their companies at risk by approving policies that require the insured's consent when that person suffers from dementia or lacks sufficient reasoning capabilities. As for use of the contribution once it was received by the beneficiary, nothing in the bill would prevent an interested donor and a charitable organization from making an agreement regarding the purpose of the gift.

Opposing Argument
The bill should prohibit changing the beneficiary. An insured presumably could enjoy the tax benefits of having his or her premium payments considered charitable contributions, then change the policy's beneficiary to a loved one shortly before death.

Response: While the insured would make the premium payments, the charitable organization would hold ownership in the policy, and only the policyholder can change the beneficiary designation.

Legislative Analyst: P. Affholter

FISCAL IMPACT

The bill would have no fiscal impact on State or local government.

Fiscal Analyst: M. Tyszkiewicz

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