Giving Through Living Trusts for Advisors

Advantages of Living Trusts in Estate Plans

Over the years, many individuals have established revocable living trusts as part of their overall estate planning. The benefits sought in creating such a trust may be to:

- Bypass estate administration (“probate”), although estate administration is less costly and less time-consuming in some states than in others.
- Preview a trustee’s performance.
- Shift, without losing control over, investment decisions.
- Provide a convenient way to manage assets in the event of incapacity.
- Obtain privacy in regard to one’s estate plan, although the trust agreement generally will have to be recorded and will then become a matter of public record if the trust contains real estate.

For the charitably motivated individual who sets up a revocable living trust, giving to a favorite nonprofit organization through the trust can be a convenient way to provide for charitable interests.

Charitable Gifts from Living Trusts

Donations can be made from a revocable living trust during the settlor’s life or after death.

Gifts during the settlor’s life: If the settlor of a revocable living trust wishes to use assets held in the trust to make charitable gifts, a threshold question is whether the trustee is authorized to transfer the assets directly to charity.

The trust agreement may authorize the trustee in the trustee’s discretion to distribute trust assets to the settlor or apply trust assets for the settlor’s benefit. Or the trust agreement may provide that the settlor may direct the trustee to distribute trust assets to the settlor or apply trust assets for the settlor’s benefit.

In either of these situations, if it is not clear that the trustee has authority to transfer assets directly to charity, the best course of action may be for the trustee to distribute assets to the settlor, and for the settlor then to make a personal gift to charity. This depends on how the revocable living trust instrument is drafted, even if the settlor is the trustee.

If it is clear that the trustee has authority to distribute assets to charity, and the trustee makes such a distribution, the gift will be deemed to be made by the settlor for federal tax purposes, and the settlor, accordingly, should therefore receive a receipt for the gift.

If the settlor is incapacitated, a question may arise as to whether an individual holding a general durable power of attorney from the settlor may direct the trustee to distribute assets to charity (or, for example, to use assets of the revocable living trust to create a charitable remainder trust). The answer to this question lies in the language of the revocable living trust agreement and in the language of the power of attorney. Often, the agreement prohibits the holder of the power of attorney from modifying or revoking the trust, which may block the trustee from following directions of the attorney-in-fact to make a charitable gift, absent express authority to follow such directions.

On a somewhat related point, the Internal Revenue Service has ruled on a number of occasions that the holder of a general durable power of attorney has no authority to make gifts (typically, $15,000 annual exclusion gifts to family members) out of assets to which the power pertains unless the power of attorney expressly authorizes the making of such gifts or applicable state law grants the holder of the power such authority.

Gifts made out of the revocable living trust at the settlor’s demise: Amounts left to charity from a revocable living trust at the settlor’s death generally qualify for the federal estate tax charitable deduction under IRC section 2055, because the amounts are included in the settlor’s gross estate and are considered to be transferred to charity by the settlor.

Generally, any gift arrangement that can be established by will can be arranged under the terms of a revocable living trust, although there are some fine points to be observed in dealing with revocable living trusts that are to distribute assets to a charitable remainder trust.

Distribution to a charitable remainder trust: If assets are left from a revocable living trust to a charitable remainder trust, the federal income tax regulations require that the assets be transferred from the living trust to

the charitable remainder trust (i.e., from the trustee of the former to the trustee of the latter), so that the two trusts are separate and distinct. See Reg. section 1.664-1(a)(6), Example (4).

If the revocable living trust is to pay the settlor's debts, federal estate tax and any state death taxes, it is important that the distribution to the charitable remainder trust be net of the debts and taxes so that none of the debts and taxes are paid by the charitable remainder trust. See Reg. section 1.664-1(a)(6), Example (3).

Although the charitable remainder trust may not be funded by the revocable living trust immediately upon the settlor's death, the obligation of the charitable remainder trust to make payment of the annuity or unitrust amount should begin on the date of the settlor's death. In this regard, see Reg. section 1.664-1(a)(6), Example (4)(i), and 1.664-1(a)(5).

The charitable remainder trust will be deemed created once it is partially or completely funded. This is significant because distributions made by the charitable remainder trust and any undistributed income of the charitable remainder trust will be governed for tax purposes by IRC section 664 (meaning, for example, that any undistributed income of the charitable remainder trust will bypass federal income taxation by reason of the trust's exemption from federal income tax under IRC section 664(c)). Post-mortem distributions by the living trust to the beneficiary(ies) of the charitable remainder trust are not governed by the special rules of section 664, but rather by the usual rules governing trust distributions. See Reg. section 1.664-1(a)(6), Example 4(ii). See section 664 for rules concerning maximum and minimum payout rates and charitable remainder values.

Income in Respect of a Decedent (IRD) items: If an individual plans to leave income in respect of a decedent to a revocable living trust at his or her death, it can make sense to use the IRD items to make charitable bequests. IRD left to an individual is generally subject to both federal income tax and federal estate tax. IRD left to charity, on the other hand, bypasses both income tax (because of the charity's tax-exempt status) and estate tax for the charitable gift portion (because of the estate tax charitable deduction).

It is important, however, for the instrument creating the revocable living trust specifically to direct the IRD item(s) to charity, in order to be assured that the trust does not pay income tax on the IRD. For details, see IRC section 642(c)(1) and the corresponding regulations. (Another solution might be to bequeath the IRD item(s) directly to charity.)

Conclusion: Many of the same tax and drafting considerations come into play when planning a post-mortem charitable gift from a revocable living trust as come into play when planning a charitable bequest. Much guidance regarding the tax issues can be found in Reg. sections 1.642(c)-1, 1.664, and 20.2055-1.

Appendix

General Tax Information

Charitable gifts of cash and "cash equivalents" may be deducted in one year up to 60 percent of a giver's adjusted gross income. The limit is generally 30 percent of adjusted gross income for gifts of long-term appreciated property.

Gift amounts in excess of these limits may be deducted in as many as five succeeding tax years. See Internal Revenue Code section 170(d)(1)(A).

Federal Gift and Estate Tax Considerations

Gift and estate taxes: The Tax Cuts and Jobs Act of 2017 continued the trend toward reducing the impact of federal estate and gift taxes on personal estate planning. Effective January 1, 2018, the Act doubled the planned $5.6 million estate and gift tax exemption amount to $11.18 million for individuals and $22.36 million for a married couple. These amounts will continue to be indexed for inflation in future years. The maximum tax rate remains 40% for estate and/or gift taxes beyond the exemption amount.

Annual gift exclusion: In 2018 an individual can give up to $15,000 a year to each of as many other individuals as he or she wishes without having to report or pay tax on the gifts (IRC section 2503(b)). This exclusion amount is subject to an inflation adjustment each year. Check for latest amounts.

The annual gift exclusion, however, is available only with respect to gifts of "present interests."

Gift-splitting: Gift-splitting by spouses permits a gift made by one spouse to be treated as having been made one-half by each spouse (IRC section 2513). Gift-splitting allows the annual exclusion effectively to be doubled. It also "shifts" half the gift to the non-donor spouse for purposes of the unified gift and estate tax credit. Gift-splitting can be accomplished only by the timely filing of a federal gift tax return (Form 709) and by signifying

consent to gift-splitting on the return (IRC section 2513(b)). An election to split gifts applies to all gifts made during the calendar year by the spouses (IRC section 2513(a)(2)).

Charitable gifts and bequests: In general, any amount can be given to a qualified charity during life or at death, free of federal gift and estate taxes, because of the unlimited gift and estate tax charitable deductions (IRC sections 2055 and 2522).

In the case of an outright donation in excess of $15,000, the first $15,000 of the gift qualifies for the annual gift exclusion under IRC section 2503(b); the balance of the gift qualifies for the gift tax charitable deduction. A gift tax return need not be filed in this case to claim the deduction.
