

Giving Through Living Trusts

General tax information

Charitable gifts of cash and “cash equivalents” may be deducted in one year up to 50% of a giver’s adjusted gross income. The limit is generally 30% 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

One of the most important aspects of the [Economic Growth and Tax Relief Reconciliation Act of 2001](#) was the provision for the gradual elimination of the federal estate tax.

The amounts that will be exempt from estate tax each year will steadily increase through 2010, when the estate tax will be repealed. The top estate tax rate was reduced from 55% to 50% in 2002 and will then be reduced over time prior to its scheduled elimination.

Under the terms of the 2001 Tax Act, many Americans who were subject to estate tax have seen their liability for this tax eliminated due to the increases over time in the threshold amount beyond which the tax applies.

As a result, a growing number of persons will have more assets to provide for family, friends, and charitable interests.

Note the phase-in schedule for exemption amounts and maximum estate tax rates now and in coming years:

Estate Phase-Out Schedule

Year	Exempt Amount	Maximum Rate
2002	\$1,000,000	
2003	\$1,000,000	
2004	\$1,500,000	50% 49%
2005	\$1,500,000	48% 47%
2006	\$2,000,000	46% 45%
2007	\$2,000,000	45% 45%
2008	\$2,000,000	0%
2009	\$3,500,000	
2010	Tax Repealed*	

* Estate tax is eliminated beginning in 2010, but provisions of 2001 law call for repeal of all changes unless re-enacted before the end of 2010, so repeal may be effective for one year only.

It will still be possible to transfer unlimited amounts to spouses during one’s lifetime and at death, so with proper planning it will continue to be unnecessary for married couples to pay estate tax at the death of the first spouse.

As in the past, unlimited amounts can also be left for charitable purposes free of estate and gift taxes.

Gift tax retained

Even after 2010, the 2001 Tax Act retains the gift tax for lifetime transfers. Beginning in 2002, as in the case of the estate tax, the exemption for lifetime gifts was raised to \$1 million. Unlike the estate tax, however, the amount exempt from gift tax is not scheduled to increase above that amount.

Amounts beyond \$1 million given to others will be subject to tax at the same rate as estate tax rates until 2010, when the maximum gift tax rate will be the same as the highest individual income tax rate, scheduled under the terms of the new law to be 35% at that time.

Congress is thus phasing out the tax due on assets passed at death, but has retained the transfer tax on certain amounts given to others during one's lifetime.

Annual gift exclusion: An individual can give up to \$13,000 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 a special inflation adjustment effective after 1998.

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 \$13,000, the first \$13,000 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.

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, \$13,000 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 [Regulation 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 642, 664, and 2055](#).

Source URL (retrieved on 09/20/2021 - 05:40): <https://brethren.givingplan.net/giving-through-living-trusts>