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Testamentary Charitable Gifts: Bringing Peace to a Stressful World

Endless traffic. Constant deadlines. Family pressures. Business goals. Sometimes, the modern world feels like a relentless pressure cooker. Fortunately, successful, hard-working people find ways to reduce the pressures of modern life. Some retreat to peaceful pursuits to relax. Others do the exact opposite, engaging in sports or rigorous exercise to let off steam.

Planning related to end-of-life matters presents another stressful challenge. Unfortunately, clients often choose to cope with this stress by procrastinating or postponing planning decisions, even when they understand, intellectually, how important it is to address these concerns. For stressed and reluctant clients who are philanthropically inclined, testamentary charitable gifts might just be an ideal option.

In this issue of *The Good Advisor*, we look at testamentary charitable gifts—in particular, how these gifts may benefit clients who want to leave a charitable legacy as part of an estate plan but don't want to make lifetime changes or relinquish control of their assets.

Charitable Bequests: The Basics

The most fundamental of all human actions is, of course, breathing. We take thousands of breaths every day—each breath is a little miracle to which we give little or no thought. Yet, becoming intentional about each breath can actually reduce stress. According to the American Institute of Stress, deep breathing triggers a "relaxation response" that decreases metabolism and blood pressure, slows the heart, relaxes muscles, and increases the levels of nitric oxide in the blood.[1]

Careful planning can also reduce stress. When it comes to estate planning, the most fundamental of all tools is a will. A will lets clients distribute estate assets at death, name a personal representative (or executor) for the estate, and designate a guardian for minor children. Though a will provides two methods for disposing of property—the bequest (a gift of personal property) and the devise (a gift of real property)—in some modern statutes, there is no longer a distinction between "devise" and "bequest," and devise may, by statute, mean a gift of real or personal property.[2]

Bequests are divided into three categories:

- **A specific bequest** is a gift of a specific asset to a named beneficiary—say, the gift of a particular work of art to a museum.
- **A demonstrative bequest** is one that identifies a specific amount of money from a particular source—perhaps a gift of $250,000 from a personal checking account to the donor's favorite religious institution.
- **A general bequest** directs that a gift (a specific dollar amount or a percentage of the remaining estate) be made from the general funds of the estate. A general bequest is fulfilled after all specific and demonstrative bequests.

A charitable bequest is a popular giving method because bequests are an easy way for clients to create a legacy, qualify for an estate tax deduction, and support charity. While simple to make, the impact of a bequest on the donor and the charity cannot be ignored, especially when charitable organizations regularly report testamentary gifts of $1 million, $10 million, or more.

Deductibility

When properly made, a bequest in any form—a specific dollar amount, a particular asset, a certain

percentage of the available estate, or the estate residue—will qualify for an estate tax charitable deduction under IRC §2055(a) if it is:

- Included in the decedent's gross estate,
- Transferred by the decedent by will, and
- Made to a qualified charitable organization as defined under estate tax rules.[3]

A "qualified charitable organization" generally means any domestic or foreign "corporation or association organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes" that will use the asset exclusively for charitable purposes.[4]

Drafting the Bequest

The donor must draft the bequest with care, since errors in bequest language and execution can jeopardize the deduction.

Incorrect identity. The will must identify the charity with its correct legal name and address. Incorrect identification may cause both the gift and the deduction to fail.[5] Even if the bequest is initially correct, however, the charity may change names, reorganize, merge with another organization, or even cease to exist. The donor can plan for this by naming a contingent charitable beneficiary to accept the donation only if the original charity cannot.

Third-party involvement. Bequeathed property cannot pass through a third party to a charity. Let's say Brenda leaves estate property to her sister, May, with instructions for May to use that property to make a charitable gift on Brenda's behalf. This invites the question of who has actually made the gift—Brenda or May? Even though the charity ultimately receives the bequest property and the initial beneficiary never had any intention of keeping the property, a "roundabout" bequest does not secure the charitable deduction.[6] Even if the donor makes a bequest gift to a fraternal organization, and that organization specifically uses it for charitable purposes, the bequest does not qualify for a charitable deduction without the testator's clear stated intent that the gift be used exclusively for charitable purposes.[7]

Unspecified amount. If testators do not specify the dollar amount, asset, or percentage of the available estate to be transferred to a charitable organization, they jeopardize the estate tax charitable deduction. In the case of *Humes v. United States*, the Supreme Court said:

> Did Congress, in providing for the determination of the net estate taxable, intend that a deduction should be made for a contingency, the actual value of which cannot be determined from any known data? Neither taxpayer, nor revenue officer—even if equipped with all the aid which the actuarial art can supply—could do more than guess at the value of this contingency. It is clear that Congress did not intend that a deduction should be made for a contingent gift of that character.[10]

A failure to specify the amount of a charitable bequest may force the executor or personal representative to make that decision, or may prevent the gift value from being ascertained at all.[11]

Contingent bequest language. Bequest language is considered contingent (or conditional) if the charitable transfer depends on the occurrence or non-occurrence of some event.[12] The use of contingent language to convey a charitable bequest will not jeopardize an estate's charitable deduction provided the chance that the charity will not receive the bequest is "so remote as to be negligible when it is determined on the decedent's date of death."[13]

What about an unnamed charity?

While this would appear to be a problem, the testator can take steps to secure the estate tax charitable deduction even without naming an exact beneficiary.[8] As the IRS noted in a Revenue Ruling, the decedent will be deemed to have effectively made the transfer if local law provides that the terms of the will impose a trust over the assets and require the trustee to distribute the bequest property only to qualified charitable organizations (as stated in IRC §2055).[9]

Testamentary Gifts of Retirement Assets

Regular exercise throughout the years not only combats stress—it increases the chances of good physical and mental health in old age. Financial planning may sound stressful, but much like exercise, those who practice solid retirement planning over the years increase their chances of having strong financial health in retirement. This, in turn, relieves stress and lets the retiree enjoy the results of a lifetime of work. It also provides an opportunity to realize charitable giving goals through a testamentary gift of retirement assets—perhaps an even more significant gift than would otherwise have been possible.

A Beneficiary Designation

The most straightforward method of making a testamentary charitable gift of retirement assets is to name the charity as the beneficiary of an IRA

or retirement plan. The donor simply completes a new beneficiary form. Of course, it is important to confirm with the plan administrator or custodian that there are no restrictions on designating a charity as a beneficiary. Also, married donors may be required to obtain spousal consent.[14] Because the amount in an IRA or retirement account will change over time, it is prudent for the donor to specify a percentage gift rather than a dollar amount.

Income in Respect of a Decedent (IRD)

IRD refers, of course, to income earned during life but not included in the decedent's gross income prior to death.[15] Traditional IRAs, qualified retirement plan accounts, and savings bonds all fall into this category—in fact, these items represent a significant percentage of IRD in most estates.

Because it hasn't been taxed yet, IRD is generally includible in the gross income of the recipient (estate or individual) and taxed at the recipient's income tax rate. Whether the property passes through the probate estate or outright to the recipient, it retains the same character it would have had in the decedent's hands.

If the income in respect of a decedent represents gain (capital or ordinary) on the sale of an asset, the recipient may utilize the decedent's basis to offset the gain. The basis of appreciated property does not step up to the fair market value at death, even though the IRD is included in the gross estate. IRD is includible in the decedent's gross estate as a property interest or right that passes at death.

IRD items left to charity qualify for the estate tax charitable deduction and also negate the adverse income tax consequences for the recipient because of the charity's tax-exempt status. It is often a sound tax strategy for a donor to leave IRD assets to charity and non-IRD assets to individuals.

Stress and the Five O'clock Hour

"It's five o'clock somewhere!" This common expression heralds the end of work—even when the actual clock says otherwise. For successful individuals who have navigated the shoals of a stress-filled life, the prospect of retirement years brings the same sort of anticipation. During the dreaming, planning, and re-evaluating of the pre-retirement years, clients may decide that a testamentary gift is the best way to realize a charitable legacy. While these clients are "calling it a day," a charitable gift will continue working long after they are sailing into the sunset.

ENDNOTES

1 stress.org/take-a-deep-breath

2 For example, the Florida Probate Code defines devise as follows:

"Devise," when used as a noun, means a testamentary disposition of real or personal property and, when used as a verb, means to dispose of real or personal property by will or trust. The term includes "gift," "give," "bequeath," "bequest," and "legacy." A devise is subject to charges for debts, expenses, and taxes as provided in this code, the will, or the trust.

3 See also Reg. 20.2055-1(a).

4 Reg. 20.2055-1(a)(2). The IRS maintains a non-exclusive informational listing of qualified charitable organizations in Publication 78.

5 *Levey v. Smith*, 103 F.2d 643 (7th Cir. Ind. 1939). The court said, "The meaning of this language is that the testator and he alone must provide for the charitable bequest. It means that the provision by the testator must be one that is definite in ascertainment and that is legally enforceable; it must possess the quealities [sic] of a definite command which will define the legal rights of all parties to the property intended to be affected."

6 Ltr. Rul. 200437032.

7 IRC §2055(a)(3); *Levey* at 646. The court said, "The right to a deduction depends upon what a testator has willed respecting the use of a legacy and not upon the use which a legatee is willing to make of it."

8 *United States v. First Nat'l Bank*, 74 F.2d 360, 363 (5th Cir. Ala. 1934). The 5th Circuit Court of Appeals stated: It is well settled in Alabama that "a charitable trust will not fail on account of any uncertainty as to the ultimate beneficiaries, within a properly designated class, if there is a competent trustee to make a selection and thereby render certain the beneficiaries who are to enjoy the bounty provided by the trust."

9 Rev. Rul. 69-285, 1969-1 C.B. 222.

10 *Humes v. United States,* 276 U.S. 487 (U.S. 1928); *Estate of Marine v. Commissioner,* 97 TC 368 (1991), aff'd 990 F2d 136, 71 AFTR2d 93-2182 (4th Cir. 1993).

11 *Florida Bank at Lakeland v. United States*, 443 F.2d 467 (5th Cir. Fla. 1971). The appellate court upheld the district court ruling that the taxpayer was not entitled to a charitable deduction for the charitable remainder because the requirement that the trustee pay over all capital gains to the life beneficiaries prevented the value of the charitable remainder from being ascertainable.

12 Reg. 20.2055-2(b)(1); *Commissioner v. Estate of Sternberger,* 348 U.S. 187 (U.S. 1955); *Bach v. McGinnes*, 333 F.2d 979 (3d Cir. Pa. 1964).

13 Reg. 20.2055-2(b)(1).

14 IRC §417(a)(2).

15 IRC §691.

Access more information now!

An electronic copy of our companion booklet with more details including a discussion of the basic components and considerations of charitable testamentary trusts is available in the Professional Advisor section of our webite at **www.catholicfoundation.com.**

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