When Are Taxes Optional?

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Benjamin Franklin wrote to a friend in 1789, “In this world, nothing is certain except death and taxes.” Ben was half right. Taxes are optional. At death, anyway. They are optional even for taxpayers with estates large enough to owe state or federal estate tax. They are also optional for taxpayers who have funds subject to income tax at their death, such as amounts remaining in their retirement accounts. The solution? Give the taxable assets to charity.

Bequest to Charity in a Will

One simple and popular to method for giving to charity at death is by including one or more charitable gifts in one’s will. The bequest can be a specific amount, a specific percentage of what is left of the estate after all other obligations have been met, or either of these if one or more conditions are met, such as the prior death of a spouse. Regardless of how the amount going to charity is determined, every one of those dollars is deductible from the deceased’s taxable estate. If the amount given to charity is enough to reduce the taxable estate to less than the amount exempt from applicable federal and state estate taxes (about one third of states have an estate or inheritance tax), the estate will owe no estate tax. Donors who are strongly philanthropic can even have their will define the amount to give to charity as the amount needed to reduce estate taxes to $0.

A bequest to charity is a wonderful way for a donor to perpetuate their values after they are gone. A bequest to charity is also completely revocable, should the donor’s circumstances change. This flexibility can be reassuring to many donors who are concerned about health costs or other potential future expenses.

To encourage bequests from your donors, remind them in communications, whenever you can, that your charity is pleased to receive bequests. Also, be sure sample bequest language, including your charity's legal name and tax ID number (EIN), is easy to find on your charity's website.

Beneficiary Designations

Beneficiary designations for retirement accounts, life insurance policies, savings accounts, brokerage accounts, and certain other accounts, share many similarities with a bequest in a will. The assets pass to the beneficiary at the death of the owner. They also have the same flexibility: they are completely revocable should the owner's circumstances change. And they are even easier to set up than a bequest in a will: the owner just fills out a simple form. No lawyer required.

Generally speaking, administrators of these kinds of accounts don't want account owners to designate a specific amount to go to a charity. They prefer the amount be defined as a percentage of the value of the account at death. Also, unlike in a will, where a donor can go on at length to define the purpose of the gift, or how the gift amount must be determined, beneficiary designation forms typically don't provide room to describe any restrictions. Those can be described in a separate, referenced document. When there is a conflict between a donor's will and a beneficiary designation, the beneficiary designation takes precedence, since it bypasses the probate estate. The will controls the assets only in the probate estate.

In recent years, many charities have recognized that the huge amounts donors hold in retirement plans and other financial accounts represent a fantastic fundraising opportunity. Retirement plan assets are a particularly attractive source of funds, because they are subject to income tax if they do not go to charity, whether or not the donor's estate is large enough to owe estate tax.

As with charitable bequests, remind donors in communications whenever you can that they should consider beneficiary designations to support the charities they care about. Be sure information on how to designate your charity as a beneficiary is easy to find on your charity's website. It's also a good idea to remind your donors that it's best to keep your organization informed about the gift, especially if they are interested in any particular uses for the funds.

Testamentary Life Income Plans

The great majority of gift annuities and charitable remainder trusts are funded during the donor's lifetime. Funding these gift plans at death has its place, however. For example, a donor may want to benefit children or other heirs with an income stream only after the donor passes away, or the donor may want the flexibility to change their mind for any reason; the gift won't become irrevocable until the donor passes away.

If the donor is planning to fund a gift annuity or charitable remainder trust with retirement plan assets, waiting to do so until death offers particular advantages. During life, the donor who wishes to avoid paying income tax on some of the retirement assets used to fund a life income gift is limited to making a Qualified Charitable Distribution (QCD) from an IRA. In addition, to qualify as a QCD, the contribution amount cannot exceed $55,000 in 2026 (this limit is adjusted for inflation each year). At death, in contrast, the donor can use a beneficiary designation to fund a life income plan with any amount and from any defined contribution plan (IRA, 401(k), 403(b), etc.). This approach avoids all the income tax the donor's estate would have to pay if it received the funds from the retirement plan and then turned around and funded the life income plan. Again, to avoid exposing the retirement assets to income tax, it is crucial that the donor designate the charitable remainder trust or the charity issuing the gift annuity as the beneficiary of the retirement assets, not the donor's estate.

Illustrating Testamentary Life Income Plans

PG Calc will release a new update of *PGM Anywhere* within the next few weeks. The updated *PGM Anywhere* enables you to illustrate a testamentary life income plan, lead trust, or retained life estate funded with any property type. You can also compare using the gift amount to fund a planned gift versus giving the same assets to heirs. Based on the assumptions you enter in the new Plan to Model window and elsewhere, the software can compute all the applicable taxes - federal estate tax, state estate or inheritance tax, generation skipping tax, and income tax. You will find these taxes itemized on the Summary of Benefits Projection chart. All other presentations have been adjusted, as needed, to reflect testamentary planned gifts.

We look forward to making these capabilities available to you very soon!