6 Charitable Planning Strategies for Your Estate Plan

By Faith DeNoble, Esq.

When creating your estate plan, there are many options for tax savings, strategic planning, and securing a legacy for your loved ones. For many people, planning may also involve emotional decisions, asking questions such as how can I leave a legacy, or what kind of lessons do I want to pass down to my children when I'm gone?

Charitable giving not only allows socially conscious planning, but it is also used as a tool for tax planning. After death, an estate or trust can deduct gross income paid to a qualified charity yearly. Additionally, assets such as stocks that may be subject to long-term capital gains may be donated strategically to offset income taxes in a current year.
This article discusses six estate planning strategies, varying in complexity, that may fit different estate plans for different reasons.

Charitable Bequests

One of the common and simplest charitable giving strategies is through a charitable bequest in a Last Will and Testament or Revocable Trust. A bequest of this kind directs a specific dollar amount, percentage, or a particular asset to be directed to a charity.

These bequests can be made through a specific bequest or as a percentage or fraction of the residuary estate. A specific bequest refers to a pre-residuary gift that is distributed before the remainder of the estate. A common example of a specific bequest to a charity may look like:

"I give $5,000 to Charity X for their charitable purposes".

If you wish to make a charity or charities a larger part of your giving, a remainder gift will allow a percentage or fractional share of your assets to be given. A common example of a residuary gift to a charity would be:

"I give 50% of my residuary estate to Charity X for their charitable purposes".

Charitable bequests can also be structured to be contingent, meaning the gift only takes effect under certain conditions, such as the prior death of another beneficiary. These bequests offer great flexibility, allowing your estate to go to a

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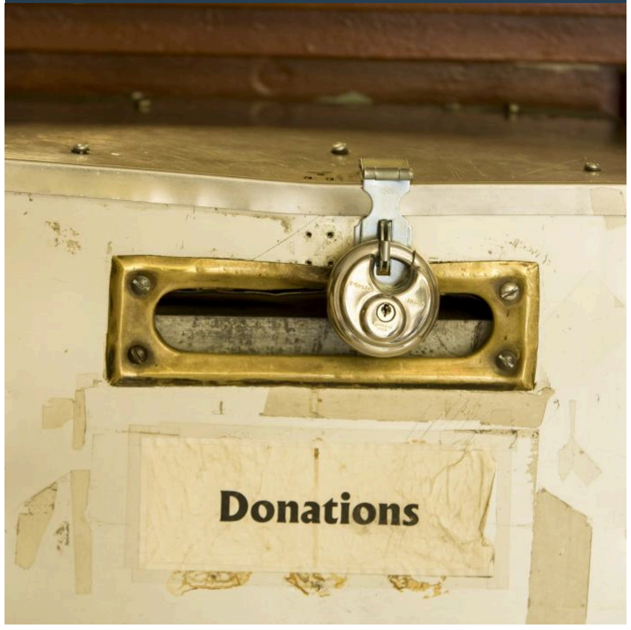

cause that matters to you in the event of a loved one's death. These bequests can be revised or revoked at any time during the donor's life, and they do not require the donor to part with any assets until death.

From a tax perspective, charitable bequests can reduce the taxable estate, which may ultimately benefit heirs by lowering estate tax liability. For those seeking a simple yet impactful way to support charitable causes, a bequest offers a clear and straightforward path.

Charitable Remainder Trusts (CRTs)

Charitable Remainder Trusts (CRT) are a great tool for individuals who are interested in philanthropy but wish to have a stream of income for their loved ones (or themselves) for life or a number of years. These irrevocable trusts provide an income stream for a term, and upon the end of the term, the remainder of the trust assets pass to a designated charitable organization.

There are two primary types of CRTs: the Charitable Remainder Annuity Trust (CRAT), which pays a fixed annual amount (at least 5% and no more than 50% of the principal of the trust when the trust is established), and the Charitable Remainder Unitrust (CRUT), which pays a fixed percentage of the trust's annually revalued assets (at least 5% and no more than 50% of the principal of the trust calculated annually). A CRUT may allow more flexibility by allowing the percentage to be calculated yearly, which may combat inflation and permit additional contributions over time, while a CRAT allows beneficiaries a predictable source of income from year to year.

Donors often fund CRTs with highly appreciated assets such as real estate or securities, as these trusts can sell the assets without incurring capital gains taxes. In addition to deferring income taxes or eliminating capital gains, donors receive an immediate charitable income tax deduction based on the present value of the remainder interest that will eventually go to charity.

CRTs are particularly appealing to donors who want to convert illiquid or low-income-producing assets into a steady income stream while still committing to long-term charitable giving.

Charitable Lead Trusts (CLTs)

A Charitable Lead Trust (CLT) is essentially the inverse of a CRT. While a CRUT or a CRAT allows you to provide for a loved one first, and then give the remainder to charity, a CLT provides a stream of financial support to a charity for a period of time, with the remaining assets going to your intended family or other beneficiaries.

CLTs are similar to CRTs in that they are also able to be unitrusts or annuity trusts (fixed amount based on when the trust is establish –annuity, or on an annual basis—unitrust). Dissimilar to a CRT, a CLT is not limited to a 5% minimum or 50% maximum rule, and does not have the same restrictions on the lifetime of the trust.

CLTs are a favored tool among high-net-worth individuals looking to reduce estate and gift taxes. In grantor trust CLTs, where the grantor is treated as the owner of the trust's assets for income tax purposes, the value of the gift to the heirs is reduced by the estimated value of what will be distributed to a charity, which will allow donors to transfer significant wealth to the next generation at a reduced tax cost.

In non-grantor trust CLTs, where the trust is considered the owner of the assets and pays it owns taxes, the trust is able to claim an unlimited income tax charitable deduction for its distributions to the charitable beneficiary, thereby reducing the amount paid in gift or estate tax.

While CLTs do not offer a donor the opportunity for an income stream during life like a CRT, they allow the donor to witness the charitable impact during their lifetime and eventually pass assets to heirs under favorable tax conditions.

Donor-Advised Funds (DAFs)

Donor-Advised Funds (DAFs) have emerged as one of the fastest-growing vehicles for charitable giving, with over $54.77 billion in grants made from DAFs to charitable organizations in 2023. A DAF is a giving account established under the umbrella of a sponsoring public charity. Donors make irrevocable contributions to the fund and receive an immediate tax deduction. They can then recommend grants from the fund to qualified charitable organizations over time.

DAFs are used by donors for their simplicity, flexibility, and low administrative burden. They allow donors to make contributions in years when they want to maximize tax benefits —such as in a high-income year—while spacing out actual grant distributions over many years. Assets within a DAF can be invested and grow tax-free, allowing for actual distributions to be larger than they would be from taxed assets.

For families interested in establishing a tradition of giving or involving children in philanthropy, DAFs can serve as an educational tool and a way to engage multiple generations in charitable decision-making. DAFs are often tied to local organizations, which allow your giving to take place and impact your own community.

Private Foundations

For high-net-worth donors seeking maximum control and a long-term philanthropic structure with legacy in mind, private foundations are often the vehicle of choice. A private foundation is a nonprofit organization created and funded by an individual, family, or corporation. Some of the more notable private foundations are the Bill & Melinda Gates Foundation and the Ford Foundation. Depending on its structure, a foundation can make grants to public charities or run its own charitable programs.

Unlike DAFs, private foundations offer complete control over grant-making decisions, investment choices, and operations. They are subject to strict regulatory and reporting requirements, including annual minimum distribution rules and excise taxes on net investment income. While more complex and expensive to establish and maintain, private foundations are ideal for donors who want to build a philanthropic legacy, fund large-scale initiatives, or maintain long-term engagement with charitable activities.

Pooled Income Funds

Pooled Income Funds offer another way to support charitable organizations while retaining an income interest without having to do any of the heavy lifting. These are trusts maintained by a public charity that combine donations from multiple donors into a common investment pool. Each donor receives a proportional share of the fund's income for life, and upon the donor's death, their share of the fund's principal is distributed to the charity.

Pooled Income Funds are often managed by universities and other large institutions. They offer donors an immediate income tax deduction, a lifetime income stream (for yourself, or others), and the satisfaction of contributing to a larger collective endowment. While not as flexible as CRTs, they are easier to set up and ideal for donors who want a relatively simple planned giving tool with shared investment management and who have a highly appreciated asset such as securities to donate. These funds also allow a current year deduction on income taxes.

Conclusion

Charitable estate planning provides a spectrum of opportunities to create a meaningful and lasting legacy. Whether through a straightforward bequest, a charitable trust, a flexible donor-advised fund, a pooled income fund or a family-run foundation, these tools enable individuals to fulfill philanthropic goals while optimizing tax benefits.

By choosing the right combination of charitable planning strategies, individuals can ensure that their wealth supports not only their loved ones but also the broader causes that define their values and vision for the future. Each of these strategies carries distinct tax implications, legal requirements, and administrative responsibilities. If you are interested in incorporating charitable planning as part of your estate plan, please contact us at (410) 995-9870 to schedule a consultation with a member of our Estates & Trusts team.

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