

Title: Tax-Efficient Charitable Giving at Death: Issues Requiring Consideration

For individuals seeking to leave meaningful charitable legacies, properly structuring testamentary gifts can significantly enhance both philanthropic impact and tax efficiency.

In planning charitable legacies, individuals may easily overlook the complex rules governing estate tax charitable deductions, efficient asset selection, and trust structures. Understanding these intricacies is essential to ensure charitable goals are fulfilled while maximizing tax benefits for estates and heirs. From ensuring certainty of bequests to selecting optimal assets and structures, each decision point can significantly impact both the charitable organization's benefit and the estate's tax position. This article examines the key considerations for structuring tax-efficient charitable gifts at death.

Securing the Estate Tax Charitable Deduction

For estates exceeding federal or state estate tax exemption thresholds, it is important to secure an estate tax charitable deduction when making a charitable bequest. The federal estate tax exemption is currently \$15 million for decedents dying in 2026 and is scheduled to increase annually with inflation. For states that impose their own estate tax, estate tax exemptions vary widely—New York has a \$7.35 million exemption for decedents dying in 2026 with a punitive “cliff” provision, while Connecticut aligns with the federal exemption.

Qualified Recipients

For a transfer at death to qualify for the charitable estate tax deduction, the recipient of the transfer must qualify as an organization described under IRC Section 2055(a) at the time of death of the decedent from whom the transfer is received. Unlike the income tax charitable deduction, the estate tax charitable deduction is available for bequests made to foreign charities and is available regardless of public charity versus private foundation status. Best practice includes conditioning bequests on the recipient's qualification under IRC Section 2055(a) and providing for alternative dispositions if such qualification is lost.

Certainty of Bequest

In addition to the recipient organization being described under IRC Section 2055(a), for a charitable bequest to qualify for the charitable estate tax deduction, the transfer must be directly from the decedent with certainty that an ascertainable amount will pass to charity. Discretionary language disqualifies the deduction. For example, “such amounts to such charitable organizations as my executors determine” fails to qualify because the amount that will go to charity is uncertain, remaining in the discretion of the executors to decide after the decedent's death. However, “one-half of my residuary estate to such charitable organizations as my executors determine” succeeds in qualifying for the deduction because the amount that will go to charity is ascertainable without exercise of discretion, even though specific recipients are not identified. Similarly, formula clauses that define the value of what is to be transferred to a charity

with reference to ascertainable amounts likewise succeed in achieving an estate tax charitable deduction.

Valuation Requirements

Depending on the type of asset that is contributed to charity, different valuation methods apply to determine the amount of a charitable estate tax deduction. Cash and marketable securities have readily ascertainable values, but real estate, business interests, art, and other non-liquid assets require qualified appraisals, which must be submitted together with a decedent's estate tax return.

Structuring Options for Charitable Bequests

Outright Bequests

Outright bequests represent the simplest approach to testamentary charitable giving, specifiable as dollar amounts, percentages, or formulas through wills, revocable trusts, or beneficiary designations.

In providing for charitable bequests, donors should be as specific as possible and ensure the accuracy of the name of the recipient charity. If the donor wishes to limit the bequest to restrict the use of the gifted funds, consideration should be given to whether precatory language would be preferable to legally binding language, to ensure that the charitable recipient has flexibility to make the best use of the gift received. If the donor wishes to narrow the scope of how gifted funds are used, the intention for the bequest must be made clear without inadvertently disqualifying the bequest for the charitable deduction.

Bequests to institutions may name the specific department and purpose, if that comports with the donor's wishes, but care must be exercised not to direct funds to an individual. For example, rather than "to Dr. Smith at University Hospital," the bequest should be phrased as "to University Hospital for cardiac research directed by Dr. Smith" to ensure the institution, not an individual, is the proper recipient.

Further, donors should research intended recipients before finalizing bequests. For tangible property such as artwork or real estate, donors should verify the charity's willingness and ability to accept and maintain the asset. Many charities prefer to sell donated property and use proceeds for their mission rather than maintaining collections or land. These conversations, while sometimes difficult, can prevent disappointment and ensure the donor's intentions align with the charity's capacity.

Family Involvement in Ultimate Disposition

For testators desiring family involvement in selecting recipients, bequests to private foundations and donor-advised funds offer flexibility. Private foundations allow trustees or board members to control which charitable purposes the funds support, but they are subject to extensive regulatory requirements, including self-dealing prohibitions and excess business holdings rules. Donor-

advised funds offer similar flexibility in determining the ultimate charitable use of transferred funds. However, once funds are given to a donor-advised fund, the sponsoring organization owns the assets, and advisory recommendations regarding charitable distributions can be rejected.

Charitable Trusts

Charitable gifts can be made outright or through wholly charitable trusts or split-interest trusts. A wholly charitable trust is subject to private foundation rules. Though private foundations are often structured as corporations, they can also be structured as wholly charitable trusts, and the considerations are largely the same. Distributions for the ultimate charitable purpose may be made over time. As the name suggests, the assets of a wholly charitable trust are irrevocably dedicated to charity, and no portion may benefit a non-charitable person.

Separate from the wholly charitable trust is the charitable split-interest trust, which is valid under local law and in which both charitable and non-charitable beneficiaries hold successive interests. Section 4947(a)(2) of the Internal Revenue Code defines split-interest trusts as trusts that are not exempt under Code Section 501(a), where not all unexpired interests are devoted to a charitable purpose, and for which a charitable deduction was permitted under Code Sections 170, 545(b)(2), 642(c), 2055, 2106(a)(2), or 2522.

Charitable split-interest trusts must conform to precise IRC Section 664 requirements. Charitable lead trusts make regular payments to charity for a term, with the remainder passing to individuals, most commonly descendants. Charitable remainder trusts make regular payments to individuals, with the remainder passing to charity. Annuity trusts pay fixed amounts annually, while unitrusts pay fixed percentages of annually revalued assets.

Charitable remainder trusts can work particularly well for providing lifetime income to a surviving spouse or close friend while ultimately benefiting charity. When a charitable remainder trust names a surviving spouse as the lifetime beneficiary, the lifetime interest may qualify for the marital deduction under IRC Section 2056(b)(8), while the remainder interest qualifies for the charitable deduction.

Interest rate environments significantly impact the effectiveness of charitable split-interest trusts. Low rates favor charitable lead annuity trusts by reducing the discount rate, making wealth transfer to remaindermen more efficient. Conversely, low rates disfavor charitable remainder annuity trusts. Unitrusts do not permit leveraging of interest rates because the payout is calculated by applying a fixed percentage to the trust's principal value each year.

If an individual is considering creating a charitable lead trust with remainder beneficiaries who are two or more generations younger, consideration must be given to the generation-skipping transfer (GST) tax. For charitable lead unitrusts, GST exemption can be allocated at inception. For charitable lead annuity trusts, GST exemption cannot be allocated until termination, making them less efficient for gifts to beneficiaries two generations or more below the donor's generation.

Charitable Gift Annuities

Charitable gift annuities function similarly to charitable remainder trusts but involve the charity assuming immediate control and management of donated assets. The charity pays annuities to named beneficiaries for specified terms or for life, with remaining assets benefiting the charity's mission. This structure often involves less regulatory burden than trusts and may be preferable when the donor has high confidence in the charity's financial stability and management. Many established charities offer gift annuity programs with online calculators to illustrate payment amounts and charitable deductions.

Strategic Asset Selection

In addition to determining the most suitable type of charitable recipient, individuals and their advisors should consider the types of assets subject to the charitable legacy. The income tax consequences of inheriting certain assets can make specific assets attractive options for charitable donations.

Retirement Assets

Traditional IRAs represent particularly attractive charitable bequest assets. Non-charitable heirs pay ordinary income tax on distributions from inherited IRAs, and the IRA value is included in the taxable estate, creating potential double taxation. When IRAs pass to charity, the charity pays no income tax due to its exempt status, and the estate receives a full charitable deduction. The optimal strategy designates retirement assets to charities while leaving non-IRA assets (other than IRD assets) to individual heirs.

Income in Respect of a Decedent

Income in respect of a decedent (IRD), governed by IRC Section 691, includes deferred compensation, uncollected wages, and bonuses earned before death but received after death. Like retirement assets, IRD items face both estate and income tax when passing to heirs. Charitable bequests of IRD items eliminate income tax while generating estate tax deductions, making them more efficient gifts than assets receiving a step-up in basis.

Closely Held Business Interests

If an individual wishes to bequeath closely held business interests to charitable organizations, careful attention to unrelated business income tax (UBIT) and excess business holdings rules is required.

UBIT applies when exempt organizations regularly conduct unrelated trades or businesses. While passive investment activities are generally excluded, income related to debt-financed property may trigger UBIT. Excess business holdings rules may also impose tax. Business holdings received by gift or bequest are not treated as excess business holdings for five years following receipt. For estates, the five-year grace period does not begin until the holdings are actually distributed to the exempt organization.

These rules are complex and should be discussed before providing for a charitable legacy of business interests.

Efficient Estate Tax Allocation

Absent specific direction, state law determines estate tax allocation. Many states follow equitable apportionment, allocating taxes proportionally among beneficiaries while exempting charitable bequests. When testators vary from default rules, careful drafting can prevent circular computation issues. If estate taxes are inadvertently directed to be paid from charitable transfers, the reduced charitable transfer decreases the charitable deduction, increasing taxable estate and tax liability. Proper allocation clauses ensure taxes are paid from non-charitable sources, preserving full charitable deductions.

Administrative Considerations

Several states impose regulatory requirements on charitable bequests. In New York, the Charities Bureau of the Attorney General is a required interest party in judicial accountings for estates with charitable bequests and for charitable trusts. Charitable trusts (excluding charitable remainder trusts) must register and file annual reports. Executors and trustees must understand state-specific requirements to ensure compliance and avoid distribution delays.

Conclusion

Charitable giving at death offers significant opportunities to support meaningful causes while achieving estate tax savings. Careful attention to drafting language, asset selection, and the structure of the gift—whether outright or in trust—is essential to ensure both philanthropic intent and tax efficiency are fully realized.