

Make Your Charitable Estate Plan Great Again

Maximizing Tax Savings With Charitable Gifts
and Bequests of Retirement Assets

The ACTEC

Heart of America Fellows Institute

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Washington Update

Tax Cut and Jobs Act of 2017 – H.R. 1

- Reduced tax rates for individuals
- Reduce maximum corporate tax rate from 35% to 21% (flat tax)
- 20% tax deduction on business income earned by pass-through S corps & LLCs and self-employed (*Attorneys, etc. are eligible*).
- Raise estate tax threshold to \$11.2 million per person
- Charitable deduction: max is 60% of income (up from 50%)
- Double the standard deduction, but eliminate deductions for personal exemptions and dependents
- Eliminate most itemized deductions except (1) home mortgage interest, (2) charitable gifts, (3) medical expenses and (4) up to \$10,000 of state & local income taxes and property taxes

Individual Income Tax Rates

	MARRIED –	(FILING	JOINTLY)
2017	2017	2018	2018
<u>Rate</u>	<u>Income bracket</u>	<u>Rate</u>	<u>Income bracket</u>
10%	\$0 – \$ 19,050	10%	\$0 – \$ 19,050
15%	\$19,050 – \$ 77,400	12%	\$19,050 – \$ 77,400
25%	\$77,400 – \$156,150	22%	\$77,400 – \$165,000
28%	\$156,150– \$237,950	24%	\$165,000– \$315,000
33%	\$237,950– \$424,950	32%	\$315,000– \$400,000
35%	\$424,950– \$480,050	35%	\$400,000– \$600,000
39.60%	\$480,050 and up	37%	\$600,000 and up

Increased Standard Deduction

	Single		Married couple – two children			
	<u>2017</u>	<u>2018</u>	<u>2017</u>	<u>2018</u>		
AGI	\$ S-AGI	\$ S-AGI	\$ M-AGI	\$	M-AGI	
* Standard deduction	6,350	12,000	12,700		24,000	
* Personal exemption	<u>4,050</u>	<u>-0-</u>	<u>16,200</u>		<u>-0-</u>	
=Taxable Income	\$ S-TI	\$ S-TI	\$ M-TI	\$	M-TI	

Increased Standard Deduction

Example: \$20,000 SALT; \$5,000 mtg & charit

	Single		Married couple – two children	
	<u>2017</u>	<u>2018</u>	<u>2017</u>	<u>2018</u>
AGI	\$ S-AGI	\$ S-AGI	\$ M-AGI	\$ M-AGI
* Itemized deduction	25,000	15,000	25,000	24,000
* Personal exemption	<u>4,050</u>	<u>-0-</u>	<u>16,200</u>	<u>-0-</u>
=Taxable Income	\$ S-TI	\$ S-TI	\$ M-TI	\$ M-TI

[std dedn]

Who Gets Tax Benefits from Charitable Gifts?

- Donors who itemize tax deductions
(who don't take the “standard deduction”)

Impact of 2017 tax changes

- * Number of returns that itemize is projected to fall from 47 million tax returns to just 19 million
- * Number of taxpayers who deduct charitable gifts is projected to fall from 36 million to 16 million.
- * Will the 20 million change their giving amounts?

WHAT TO DO ?

Tax Saving Strategies for Charitable Gifts

- Don't forget the 11% who itemize their tax deductions
- “Bunching” charitable gifts every few years
 - donor advised funds will become more popular
- Most donors over age 70 ½ should make *ALL* of their charitable gifts from their IRAs:
 - “*Charitable IRA Rollover*”

Charitable IRA Rollover

-- Lifetime Gifts from IRAs –

- Law Permanent! 2015 PATH Act
- Eligible Donors:
 - Won't report charitable gifts from IRAs as taxable income
 - Not entitled to charitable income tax deduction

Charitable IRA Rollover

-- Lifetime Gifts from IRAs --

- IRA owner must be over age 70 ½
- Maximum: \$100,000 per year
- Yes! Charitable gift satisfies required minimum distribution requirement from IRA!

WHO WINS?

- Donors who do not itemize tax deductions (“standard deduction”)
- Donors who live in states where the state income tax laws do not permit deductions for charitable contributions (Ohio, Indiana, etc)

WHO WINS ?

- Donors who incur taxes as their income increases
 - social security benefits taxable
 - Medicare “B” premiums
 - 3.8% health tax if $AGI > \$200,000$
- The heirs
 - appreciated stock gets step-up tax basis
 - inherited IRAs are taxable income

LEGAL REQUIREMENTS

- Over age 70 $\frac{1}{2}$
- IRA (only) – not 403(b), 401(k), etc.
- “Directly” from the IRA to charity
 - Checks written from
 - “IRA checkbooks” are OK

LEGAL REQUIREMENTS

- ELIGIBLE CHARITY – Public charity or private *operating* foundation
 - however, a PF, donor advised fund or supporting org is not eligible
- Must qualify for full charitable deduction – no dinners; no CGAs

LEGAL REQUIREMENTS

- Taxable part of IRA distributions (only)
 - tax-free distributions protected
- Donor must have letter from charity that donor received no goods or services in exchange for the gift

TECHNICAL ISSUES

- Yes! Charitable IRA gifts can satisfy legally binding pledges!
- Joint return? Up to \$200,000
- No withholding taxes
- Beneficiary of an inherited IRA who is over age 70 1/2 can make charitable gifts of required distributions

Three Guiding Tax Principles

- #1 - Lifetime charitable gifts usually produce more tax benefits than charitable bequests
- #2 - If charitable bequest, make it with assets that generate IRD
- #3 - Non-taxable estate? Make income-based charitable bequests

Income Tax Deductions - Charitable Bequests of IRD

- The basics : Charitable tax deductions
- IRD – What is it?
- Can a single charitable payment generate tax deductions on two separate tax returns?
- Does there have to be an “economic effect”?
- Pecuniary amounts trigger gain? Solution?
- Planning the charitable bequest
- Solutions when no instructions in governing inst

Charitable Tax Deductions

Will: “I leave \$100,000 to The College;
All income of estate: pay to my child”

- Form 706 - Charitable estate tax deduction
- Form 1041 - No charitable income tax dedn

LOGIC:

- A bequest is paid from assets owned at death
- Income is earned after death

Charitable Tax Deductions

Will: “I leave nothing to The College;
But pay all income of estate to College”

- Form 1041 - Yes charitable income tax dedn
- Form 706 - No charitable estate tax dedn

LOGIC:

- A bequest is paid from assets owned at death
- Income is earned after death

Charitable Tax Deductions

Will: “I leave \$100,000 to The College;

All income of estate: pay to my child”

- Form 706 - Charitable estate tax deduction
- Form 1041 - No charitable income tax dedn

Revenue Ruling 2003-123 - an estate will not be able to claim either a charitable *income* tax deduction **nor a *DNI* deduction** for a distribution of corpus/principal to a charity

(e.g., a typical charitable bequest)

Case Study

\$ 50,000 - interest & dividends

\$100,000 – IRD from 401(k) plan

(default beneficiary was the estate)

\$150,000 – Total taxable income

***\$300,000 – Charitable bequest;
rest of estate is payable to children***

Case Study

THE ESTATE

\$800,000 – Cash and stocks

\$100,000 – Cash from 401(k) plan

\$900,000 – Assets owned at death

\$ 50,000 - interest & dividends

\$950,000 – Total to be distributed

Case Study

When the estate pays \$300,000 to the charity, can it claim a charitable income tax deduction? If so, how much?

<u>Charit Dedn</u>	<u>Taxable income to either Estate or Beneficiaries</u>
\$ -0-	\$150,000
\$ 100,000	\$ 50,000
\$ 150,000	-0-

Income in Respect of Decedent

Amounts of income to which a decedent was entitled but which were not includible in gross income before the decedent's death. Sec. 691(a)

- Accrued savings bond interest
- Nonqualified deferred compensation
- **Retirement plan accounts**

Income in Respect of Decedent

Retirement Plan Accounts

- 1. Sec. 401 – Company plans (401(k))
- 2. Sec. 408 – IRAs
- 3. Sec. 403(b) & 457– (Charity/govt employers)
- 4. **Roth** IRAs & 401(k)/403(b)
(Tax-free; not taxable IRD)

Income in Respect of Decedent

IRD payable to an estate? Double tax:

- Form 706 - Pay estate tax – asset owned at death
- Form 1041 - Pay income tax – IRD is taxable income

*** A single payment from a retirement plan to a taxable estate will be taxed twice:**

- first on the federal estate tax return
- again on the income tax return, since it is IRD

Income in Respect of Decedent

IRD payable to an estate? Double tax:

- Form 706 - Pay estate tax – asset owned at death
 - Form 1041 - Pay income tax – IRD is taxable income
- * Argument: If IRD to charity, should be able to claim charitable deduction on both estate T/R and estate's income T/R, if governing instrument has the right instructions**
- * Law: Tax Reg: “Yes, IRD qualifies for the charitable income tax deduction”** Reg. 1.642(c)-3(a)
- Logic: IRD is both corpus and income**

Form 1041 Charitable Income Tax Deduction for Bequest of IRD?

Problem: There are situations when IRD was in fact distributed to a charity by an estate or trust, but the estate or trust was not allowed to claim a charitable income tax deduction to offset the income from the IRD.

Reason: The governing instrument had no instructions to pay income to a charity.

Form 1041 Charitable Income Tax Deduction for Bequest of IRD?

- **IRS Chief Counsel Memorandum ILM 200848020**
- Decedent left his IRA to a trust that benefited his six children and several charities
- Trust received cash from IRA; paid entire charitable share, leaving the six children as the only remaining beneficiaries of the trust.
- IRS: “Taxable income from IRA, but no charitable deduction.” Reason: trust had no instructions to pay income to charities

Form 1041 Charitable Income Tax Deduction for Bequest of IRD?

Instruction in Will or Trust :

**“If I make a charitable bequest, pay it first out of IRD, if any”
(oversimplified) ..**

**Large dollar amount of IRD? Legal argument is strengthened if a
separate checking account for IRD**

- Only deposit IRD into that account
- Write all charitable checks from that account.
So charitable payments can be traced to IRD.

Economic Effect Regulation

- **A 2012 regulation provides that when a governing instrument identifies a specific source of income to be used for a charitable distribution, the provision will control only if it has an “economic effect independent of income tax consequences.”**

Treas. Regs. Section 1.642(c)(3)(b)(2)

What Has An Economic Effect?

- ***Example of no economic effect:***

Instruction in Will or Trust :

**“I make a charitable bequest of \$100,000.
Pay it first out of IRD, if any”**

- This clause does not have an economic effect
- The charity will receive \$100,000 regardless of whether the estate has \$40k, \$30k, or no IRD

What Has An Economic Effect?

- ***Example of an economic effect:***

Instruction in Will or Trust :

“Pay all of the IRD of my estate to The Hospital”

- This clause has an economic effect
- The amount that the hospital will in fact receive will depend on the amount of the IRD that the estate collects: \$40k, \$30k, \$20k, or nothing

Economic Effect Regulation

- **A 2012 regulation provides that when a governing instrument identifies a specific source of income to be used for a charitable distribution, the provision will control only if it has an “economic effect independent of income tax consequences.”**
- **That regulation governs the character of the income distributed to a charity from a trust’s or estate’s charitable income tax deduction.**

Economic Effect Regulation

- ***Character*** of income

Tax rate

- Interest income *10% - 40.8%*
- Dividend income *0% - 23.8%*
- Long-term capital gains *0% - 23.8%*
- Tax-exempt interest *zero %*

Economic Effect Regulation

- A 2012 regulation provides that when a governing instrument identifies a specific source of income to be used for a charitable distribution, the provision will control only if it has an “economic effect independent of income tax consequences.”
- That regulation governs the character of the income distributed to a charity from a trust’s or estate’s charitable income tax deduction.
- The regulation does not prevent an estate or trust from claiming a Section 642(c) charitable income tax deduction when there is no economic effect.

Pecuniary Amount

If an estate or trust distributes appreciated property to satisfy a pecuniary obligation, the estate or trust has a taxable gain as if it had sold **the property**. Treas. Regs. Section 1.661(a)-2(f)(1); *Kenan v. Commissioner*, 114 F.2d 217 (2d Cir.1940).

Pecuniary Amount

Example: “Pay \$100,000 to my nephew”

- **Facts: Estate or trust owns stock with a cost basis of \$80,000 that is now worth \$100,000**
- **The \$100,000 stock is distributed to nephew**
- **Conclude: distribution triggers taxable gain of \$20,000.**
- **Somebody will pay tax on \$20,000:**
- **Estate or trust,**
or
- **nephew [if capital gain is distributed to nephew]**

Pecuniary Amount - Charity

Example: “Pay \$100,000 to The College”

- Facts: Estate or trust owns stock with a cost basis of \$80,000 that is now worth \$100,000
- The \$100,000 stock is distributed to College
- Conclude: distribution triggers taxable gain of \$20,000.
- **But can avoid any tax on gain if**
 - * 642(c) charit inc tax deduction to estate
(\$20,000 gain is distributed to the college)
 - * tax-exempt college pays no tax on gain

Pecuniary Amount - Charity

- **IRS Private Letter Ruling 201438014 (May 5, 2014)**
- Trust contains *pecuniary* bequests to two charities
- Probate court agrees to reform trust to qualify for favorable income tax treatment
- **IRA distributions** pay the pecuniary bequests

IRS CONCLUDES:

- Use of IRA assets to pay pecuniary obligations triggers taxable income to trust
- IRS will not respect probate court reformation

Pecuniary Amount - Charity

Could they have avoided tax if there had been instructions in the governing instrument to distribute such income to the tax-exempt charity?

- Rev. Rul. 83-75 (charitable lead trust)
- Boilerplate: *distribute to charity any income generated by making the charitable bequest*

PLANNING

TWO WAYS TO MAKE A CHARITABLE BEQUEST FROM A RETIREMENT ACCOUNT

#1 – NAME CHARITY AS BENEFICIARY OF THE ACCOUNT

***#2 – PAY ACCOUNT TO ESTATE OR TRUST THAT THEN
MAKES A CHARITABLE BEQUEST***

PLANNING

- **Hazard: Other beneficiaries cannot do *stretch IRA* if charity is beneficiary?**
- **Solutions:**
 - * **cash out charity's share by Sept 30**
 - or**
 - * **separate account for charity**

PLANNING

- **Hazard: Other beneficiaries cannot do *stretch IRA* if charity is beneficiary?**
- **Even better solution:**
 - Have a separate IRA with 100% of beneficiaries as charities; other IRA for family members, trusts, others**
 - avoid worries over Sept 30 deadline, etc**

PLANNING

ADMINISTRATIVE HEADACHE –

The Patriot Act, etc

- **IRA administrators need to retitle decedent's IRA to new beneficiary; new social security number, etc**
- **Some refuse to cut check to charity without CFO's name, address & personal social security number**

PLANNING

TWO WAYS TO MAKE A CHARITABLE BEQUEST FROM A RETIREMENT ACCOUNT

#1 – NAME CHARITY AS BENEFICIARY OF THE ACCOUNT

***#2 – PAY ACCOUNT TO ESTATE OR TRUST THAT THEN
MAKES A CHARITABLE BEQUEST***

It can be done! *PLR 201611002 (Dec, 7, 2015)*

- Several IRAs listed a trust as the beneficiary
- Trust instrument states: “my IRAs shall be distributed to Foundation.”
- IRS: “We conclude that provided that Trust pays the entire lump sum distribution to Foundation in the year received, Trust is entitled to a deduction under § 642(c)(1) equal to the amount of IRD included in Trust’s gross income as a result of the distribution of the IRAs.”

PLANNING

Want to Avoid: Estate or trust has taxable income from receiving IRA distribution,

but maybe there is no offsetting charitable income tax deduction when the IRA check is given to a charity.

Solutions:

#1 –Drafting “pay bequests from IRD...”

#2 – Plan “B” – post-mortem strategies

INCOME TAX DEDUCTIONS FOR CHARITABLE BEQUESTS OF I.R.D.

JUMP TO THE CONCLUSION:

Proposal: All wills and trust instruments should include boilerplate language that states something to the effect of :

“If I make a charitable bequest, pay it first out of IRD, if any.” (oversimplified)

INCOME TAX DEDUCTIONS FOR CHARITABLE BEQUESTS OF I.R.D.

WHY?

- Law: For a trust or an estate to claim a charitable income tax deduction under Section 642(c), there must generally be instructions in the governing instrument to distribute an amount from gross income to charity
- IRS rulings when IRD paid to charity: “No deduction since no instructions in gov. instmt”
- Solution: Insert instructions in every gov. instrm

INCOME TAX DEDUCTIONS FOR CHARITABLE BEQUESTS OF I.R.D.

Proposal: All wills and trust instruments should include boilerplate language that states something to the effect of:

Except as otherwise provided in this governing instrument, I instruct my fiduciary that all of my charitable bequests (if any) shall be paid first with taxable income in respect of a decedent (if any) included in gross income, and second with any gross income generated by making the charitable bequest (if any), so that this trust [or estate] shall be entitled to claim a charitable income tax deduction for such transfer under Section 642(c) of The Internal Revenue Code of 1986, as amended, or under any corresponding section of future income tax laws.

INCOME TAX DEDUCTIONS FOR CHARITABLE BEQUESTS OF I.R.D.

Proposal: All wills and trust instruments should include boilerplate language that states something to the effect of “pay my charitable bequests with IRD”

The problem with putting boilerplate language in every trust or will is:

The boilerplate language might conflict with other instructions that appear elsewhere in the governing instrument.

INCOME TAX DEDUCTIONS FOR CHARITABLE BEQUESTS OF I.R.D.

Proposal: All wills and trust instruments should include boilerplate language that states something to the effect of “pay my charitable bequests with IRD”

There are times you do not want IRD to be payable to a charity

- After Sept 30, limit IRA beneficiaries to DBs**
- QTIP marital estate tax deduction – spouse entitled to all income**

INCOME TAX DEDUCTIONS FOR CHARITABLE BEQUESTS OF I.R.D.

Proposal: All wills and trust instruments should include boilerplate language that states something to the effect of:

Except as otherwise provided in this governing instrument (specifically, the provisions in [Articles] [Sections] [Paragraphs] 3.1, 5.3, and 9.1),

POST-MORTEM –
WHAT TECHNIQUES AVOID INCOME TO THE ESTATE?

Solution #1 – Keep IRD off of estate’s or trust’s
income tax return

“Distribute” the IRA to charity

- Document (or state law) allows “non-pro rata” distribution of assets
- Residue of estate to charity ? IRS PLRs

POST-MORTEM –
WHAT TECHNIQUES AVOID INCOME TO THE ESTATE?

Solution #2 – Get a charitable income tax deduction to offset the IRD

- Was document drafted to get a deduction?
(I instruct that IRD etc..)
- Residue of **estate** to charity?

Pay charity in LAST YEAR. Income tax deduction since 100% of income goes to charity.

Income-Based Charitable Bequests

BACKGROUND:

- Today the typical charitable bequest is a distribution from the estate's corpus.
- For example, “pay \$50,000 to the Charity, and the remainder of my estate to my children.”
- Charitable bequests are usually viewed as providing estate tax savings but no income tax savings.

Income-Based Charitable Bequests

EXAMPLE

“Pay \$50,000 to the Charity, and the remainder of my estate to my children.”

- \$1,000,000 million estate
- \$ 60,000 taxable income during administration of estate (*\$20,000 received from an IRA (“IRD”) and \$40,000 of taxable interest and dividends*)
- \$1,060,000 – Total cash

Income-Based Charitable Bequests

What is an income-based charitable bequest?

- An income-based charitable bequest is a charitable bequest where the source of the payment is the estate's [trust's] taxable income, rather than a distribution of corpus.
- A wholesale change from the traditional way of drafting a charitable bequest.

Income-Based Charitable Bequests

EXAMPLE:

- [No charitable bequest from corpus]
- **“All of this estate’s [trust’s] income (including capital gains and IRD) shall be distributed to the Charity. If the cumulative amount of income of this estate [trust] exceeds \$50,000, then Charity shall receive only a cumulative amount of \$50,000 and all excess income shall be retained or distributed to my beneficiaries at the discretion of the executor [trustee].”**

Income-Based Charitable Bequests

- The charity will receive \$50,000 under either scenario, assuming that there is at least \$50,000 of income.
- But with an income-based charitable bequest, the estate, trust and the children will not incur an income tax liability on \$50,000 of income.
- Simplest case: generate a charitable income tax deduction to offset the income generated during the administration of an estate (or of a trust whose purpose is akin to settling a probate estate).

Income-Based Charitable Bequests

	Traditional <u>Charitable Bequest</u>	Income-based <u>Charitable Bequest</u>
<i>Distributions:</i>		
- Charity	\$ 50,000	\$ 50,000
- Child	<u>1,010,000</u>	<u>1,010,000</u>
-- Total	\$ 1,060,000	\$ 1,060,000
<i>Income taxed to:</i>		
- Charity	\$ -0-	\$ 50,000
- Child	\$ 60,000	\$ 10,000

Income-Based Charitable Bequests

Why focus on non-taxable estates?

-- Why not taxable estates?

- Taxable estate: trade-off of tax-savings from charitable deduction between estate tax (40%) and income tax (perhaps at beneficiary lower rate)
- With a non-taxable estate there is no estate tax. So the tax planning is to take steps that reduce the only tax that a non-taxable estate and its beneficiaries will incur: the income tax

The Obvious Question

Client wants a \$100,000 charitable bequest

- Expect quick administration of estate
 - Only \$30k of income? Or \$31k? Or \$32k?
- Drafting: “The first \$100k of income to charity. If less than \$100k of income, pay charity balance from corpus so that it receives total of \$100k”
- Write check to charity for \$100,000
- Q: Charitable income tax deduction for all of the estate’s income (up to \$100,000) ?
 - Confident? -- Not confident?

The Obvious Question

Client wants a \$100,000 charitable bequest

Charitable income tax deduction for all income?

- **TAX CERTAINTY:** If trustee has discretion to divide income between charity and individual.
 - Give all of the income to the charity
Treas. Reg. § 1.662(b)-2 , Example 1
 - Give discretionary \$70,000 corpus to charity
- **CHALLENGE:** Economic certainty.
Will a trustee who is family/beneficiary in fact give the extra \$70,000 to charity?

Income-Based Charitable Bequests

Bottom line:

- For a non-taxable estate, a very large income-based charitable bequest offers the potential to eliminate the income tax liability for all income earned during the administration of an estate
- Would be helpful to have guidance with PLR, revenue ruling, court decision, etc

Income-Based Charitable Bequests

Two tax challenges:

- Does estate or trust qualify for a charitable income tax deduction under Section 642(c)?
- Under the two-tier system for taxing DNI distributions to non-charitable beneficiaries (e.g., children), are the beneficiaries in the second tier so they can benefit from the charitable income tax deduction ?

Two-Tiers for DNI Distributions

- **Tier-One:** A tier-one beneficiary will be taxed on “the amount of income for the taxable year required to be distributed currently to such beneficiary, whether distributed or not.” Section 662(a)(1).
- Examples:
 - “distribute half of the income each year to “A”,
or
 - “distribute annuity from income annually to “B”

Two-Tiers for DNI Distributions

- **Tier-One:** A tier-one beneficiary will be taxed on “the amount of income for the taxable year required to be distributed currently to such beneficiary, whether distributed or not.” Section 662(a)(1).
- **Tier-Two:** All other non-charitable beneficiaries who receive distributions. For example, a beneficiary who might receive discretionary amounts of income or corpus is a tier-two beneficiary. Section 662(a)(2).

Two-Tiers for DNI Distributions

- **Tier-One beneficiaries**
- **The charitable income tax deduction is an “intermediate tier” between tier-one and tier-two. *O'Bryan v. Commr*, 75 T.C. 304 (1980).**
- **Tier-Two beneficiaries**

Income-Based Charitable Bequests

Two tax challenges:

- Does estate or trust qualify for a charitable income tax deduction under Section 642(c) ?
- ***Under the two-tier system for taxing distributions to non-charitable beneficiaries (e.g., children), are the beneficiaries in the second tier so they can benefit from the charitable income tax deduction ?***

Treas. Reg. § 1.662(b)-2 , Example 1

A trust instrument provides that \$30,000 of its income must be distributed currently to Person One and the balance may either be distributed to Person Two, distributed to The Charity, or accumulated. Accumulated income may be distributed to Person Two and to The Charity.

- **The trust for its taxable year has \$40,000 of taxable interest and \$10,000 of taxable dividends*, with no expenses.**
- **The trustee distributed \$30,000 to Person One, \$50,000 to The Charity, and \$10,000 to Person Two.**

** [modified – regulation uses tax-exempt interest rather than dividends]*

Treas. Reg. § 1.662(b)-2 , Example 1

\$50,000 income:

[\$40,000 (80%) taxable interest - \$10,000 (20%) dividends]

**“The trustee distributed \$30,000 to Person One,
\$50,000 to The Charity, and \$10,000 to Person Two”**

Income Allocation

\$30,000 – Tier One – Person One

\$20,000 – Intermediate Tier – The Charity

Sec. 642(c) charitable income tax deduction

zero - Tier Two – Person Two

Treas. Reg. § 1.662(b)-2 , Example 1

- (b) Distributable net income for the purpose of determining the character of the distribution to **Person One is \$30,000** (the **charitable contributions deduction**, for this purpose, being taken into account only to the extent of **\$20,000**, the difference between the income of the trust for the taxable year, \$50,000, and the amount required to be distributed currently, \$30,000)...
- (e) In determining the amount to be included in the gross income of Person Two under section 662 for the taxable year, however, the entire charitable contributions deduction is taken into account, **with the result that there is no distributable net income and therefore no amount to be included in gross income.**

Treas. Reg. § 1.662(b)-2 , Example 1

\$50,000 income:

[\$40,000 (80%) taxable interest - \$10,000 (20%) dividends]

CHANGE FACTS: *No Tier One Beneficiary*

**“The trustee distributed zero dollars to Person One,
\$50,000 to The Charity, and \$40,000 to Person Two”**

Income Allocation

zero – Tier One – Person One

\$50,000 – Intermediate Tier – The Charity

Sec. 642(c) charitable income tax deduction

zero - Tier Two – Person Two

Income-Based Charitable Bequests

Example: “All of this estate’s [trust’s] income (including capital gains and IRD) shall be distributed to the Charity. If the cumulative amount of income of this estate [trust] exceeds \$50,000, then Charity shall receive only a cumulative amount of \$50,000 and all excess income shall be retained or distributed to my beneficiaries at the discretion of the executor [trustee].”

[Tier-two beneficiaries]

Three Guiding Tax Principles

- #1 - Lifetime charitable gifts usually produce more tax benefits than charitable bequests
- #2 - If charitable bequest, make it with assets that generate IRD
- #3 - Non-taxable estate? Make income-based charitable bequests

FREE ARTICLE:

Google search: **SSRN Hoyt IRD**

Income Tax Deductions

for Charitable Bequests of IRD

.pdf file; easy download; 11 page article; 32 footnotes