



# **GIVING THROUGH LIVING TRUSTS**

[This space may be used for logo  
and other contact information.]



**E**very day, we make decisions about how to spend, save and manage our income and assets.

We often concentrate more on earning, spending and saving than safeguarding and planning for the future management and distribution of our property.

Your own choice of plans for managing your assets and distributing them when you no longer need them will, of course, be based on many factors, including what you own and who you wish to provide for. A planning tool known as a *revocable living trust* has proven to be a helpful addition to many people's plans.

In this booklet, we will examine how the living trust can help in the management and distribution of property, with a special look at its usefulness for people who have decided to make charitable gifts a part of their plans for the future.

## **Where to begin**

**B**efore examining revocable living trusts and how they work, let's look at two closely related topics: The probate process and the importance of having an up-to-date will.

## **The probate process and your will**

All assets left to others through your will must pass through the probate process. While different in every state, the probate system exists to prove your intent regarding the distribution of your property and make certain the instructions in your will are faithfully carried out.

If you don't leave a will and/or don't have other plans in place, the probate court will distribute your assets according to all-purpose state laws. Your property will be distributed only to certain relatives in percentages dictated by your state legislature, regardless of each individual's needs. Other loved ones and charitable interests will receive nothing, despite what you may have desired.

To avoid having these strict state laws apply, it is important you first make an estate plan—which often encompasses a will and living trust—to reflect your desires. Then, it is important to periodically review your plans so they remain current.

### **Why a revocable living trust?**

Trusts are used as a way for property owners to safeguard their assets and distribute them to others according to their wishes.

A revocable living trust is called a *living trust* because it is created during life. *Revocable* refers to the fact that such a trust may be changed or completely revoked at any time by those authorized to do so by the person who created it.

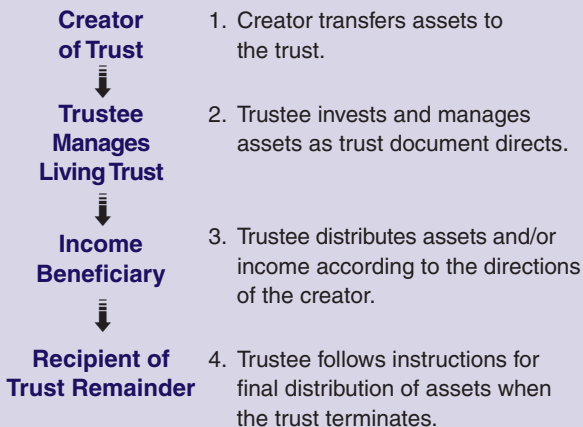
Assets in revocable living trusts are not generally subject to probate and many people make use of them to help minimize the possible expense and delays of that process. They are also useful when planning for incapacity should a person become unable to manage their assets.

## How does a revocable living trust work?

To create a revocable living trust, a document is prepared that sets out the terms of your trust, including:

- Who you wish to act as trustee and manage property in the trust during your lifetime. Many initially choose to name themselves as trustee. You can also name another person or entity you would like to be co-trustee or trustee should you no longer wish or be able to act in this capacity.
- Who should receive your property in the future. In this way, a living trust is similar to a will.

### **How a Living Trust Works**



Ownership of property transferred to a revocable living trust during life is determined at death under the terms of the trust (rather than by the terms of a will). Property transferred in this way will not pass through the probate process. Instead, the trustee named in the trust distributes the property as instructed in the trust document.

Depending on the type of property involved and other factors, it can be more efficient and cost effective to provide for the eventual transfer of property through a living trust rather than through a will.

## **Establishing your trust**

Once a revocable living trust is created, it is ready to be funded. A trust can manage and distribute only property actually owned by it.

In order to make your trust effective, you transfer assets you choose—such as your home, investments and other property—to the trust. You continue to enjoy any income and other benefits of owning property with few, if any, restrictions, since the trust may be revoked or canceled at any time.

## **What about property not in the trust?**

Because only property transferred to the trust will pass under the trust's terms, it is important to have a will that distributes any property you may have decided not to transfer to your revocable living trust or property acquired after the trust was funded.

Your will can provide how any such remaining property is to be transferred to your trust and distributed according to its terms. Such a will is referred to as a *pour-over will* because it “pours over” property into your trust. Assets passed in this way, however, will still be subject to the probate process.

## **Does a revocable living trust eliminate gift and estate taxes?**

While a revocable living trust can help minimize the expense and delays of probate, it is important to note that this plan, in and of itself, *does not* remove property from your estate for federal and/or state tax purposes.

If you are among those still subject to state and/or federal estate tax despite changes in tax laws in recent years, all property the law determines that you owned at your death, whether held in a revocable living trust or otherwise, will be included in your estate for tax purposes. Since a living trust is revocable and can be canceled at any time, the property held in it is considered to be part of one's taxable estate, as in the case of any property you owned outright at the time of death.

Like a will, your revocable living trust can be used to put in place other plans that can result in significant reductions in taxes that might otherwise be due.

### **Charitable giving opportunities**

**E**ach year, many generous Americans choose to include charitable gifts as part of their estate plans.

If you are considering making gifts and have decided to transfer all or a portion of your assets to a revocable living trust, you can make charitable gifts as part of the final distribution of the trust's assets if they are not fulfilled under the terms of your will.

You can also provide that a gift be made through your will if sufficient assets to fund intended gifts are not present in your revocable living trust at the time of your death.

## **A variety of ways to give**

When you decide you would like to make a charitable gift as part of your revocable living trust, your gift can take one of several forms:

- A specific sum of money.
- A percentage of the trust assets.
- A specific property.
- All or a portion of what's left in the trust after providing for family and/or others you name.

## **Meet family obligations first**

Through a revocable living trust, it is possible for a couple to provide for management of assets and income for both of their lives with assets remaining at the end of their lifetimes distributed to loved ones and/or devoted to charitable purposes.

**Example 1:** Mr. and Mrs. Kearns have transferred most of their assets to a revocable living trust. At the death of one of them, the trust provides for the survivor and, ultimately, their children, grandchildren and a number of charitable interests.

Both Mr. and Mrs. Kearns have been designated as trustees. However, if either is unable to serve, the other spouse has been named to take over. Should both become disabled, they have named a professional to act as trustee.

They also have wills that distribute to their trust any property not placed there during their lives.



**Example 2:** Jane is single and has no children. She decides to leave specific dollar amounts to her nieces in her revocable living trust with the remainder designated as gifts, in memory of her parents, to several causes she has supported during her lifetime.

## **Is a revocable living trust for you?**

If you are seeking a way to provide management for your assets during your lifetime while planning for the eventual distribution of property from your estate to loved ones and/or charitable interests quickly and efficiently, a revocable living trust may be the answer.

A revocable living trust can be a simple document but, like a will, it should be drafted by an attorney.

## **For more information**

Discuss your wishes with your attorney and other professional advisors. They can help you select the best course of action and put your plans in motion.

We will be pleased to answer any questions about how we can help as you consider the charitable dimension of your long-term plans.

The following section offers further information that may be helpful to you and your professional advisors.

## Technical Advisory Section

The remainder of this booklet contains more detailed information intended primarily for your professional advisors but you may find it of interest as well.

### Advantages of living trusts in estate plans

Over the years, many individuals have established revocable living trusts as part of their overall estate planning. The benefits of creating such a trust may be to:

- Bypass estate administration (probate), although estate administration is less costly and less time consuming in some states than in others.
- Preview a trustee's performance.
- Shift investment decisions (while maintaining control).
- Provide a convenient way to manage assets in the event of incapacity.
- Obtain privacy in regard to one's estate plan, although the trust agreement generally will have to be recorded and will then become a matter of public record if the trust contains real estate.

For the charitably motivated individual who sets up a revocable living trust, giving to a favorite nonprofit organization or institution through the trust can be a convenient way to provide for charitable interests.

**Gift and estate taxes:** Tax legislation enacted in 2017 provided that the amount that can be left to heirs free of federal estate tax was double the \$5 million per person allowed under previous law. This amount, indexed for inflation since 2011, is \$11.58 million per person or \$23.16 million per couple for 2020. Check for current exemption amounts.

The federal gift tax also is reunified with the estate tax. Additionally, annual lifetime gifts of \$15,000 per year per donee are allowable and do not reduce the inflation-adjusted exemption from the federal estate tax.

Since 2013, the gift and estate tax exemption is also portable between spouses, meaning that a surviving spouse can elect to use any portion of the estate and gift tax exemption not used by the predeceasing spouse. See Reg. section 20.2010-2T governing both the computation of the amount portable as well as the requirements of the election.

Married couples with assets less than twice the exemption from the federal estate tax may no longer need to make use of complex trust arrangements designed to maximize exemption and marital deduction amounts.

### **Charitable gifts from living trusts**

Donations can be made from a revocable living trust during the settlor's life or after death.

*Gifts during the settlor's life:* If the settlor of a revocable living trust wishes to use assets held in the trust to make charitable gifts, a threshold question is whether the trustee is authorized to transfer the assets directly to charity.

The trust agreement may authorize the trustee in the trustee's discretion to distribute trust assets to the settlor or apply trust assets for the settlor's benefit. Or the trust agreement may provide that the settlor may direct the trustee to distribute trust assets to the settlor or apply trust assets for the settlor's benefit.

In either of these situations, if it is not clear that the trustee has authority to transfer assets directly to charity, the best course of action may be for the trustee to distribute assets to the settlor, and for the settlor then to make a personal gift to charity. This depends on how the revocable living trust instrument is drafted, even if the settlor is the trustee.

If it is clear that the trustee has authority to distribute assets to charity and the trustee makes such a distribution, the gift will be deemed to be made by the settlor for federal tax purposes and the settlor, accordingly, should receive a receipt for the gift.

If the settlor is incapacitated, a question may arise as to whether an individual holding a general durable power of attorney from the settlor may direct the trustee to distribute assets to charity (or, for example, to use assets of the revocable living trust to create a charitable remainder trust). The answer to this question lies in the language of the revocable living trust agreement and in the language of the power of attorney. Often, the agreement prohibits the holder of the power of attorney from modifying or revoking the trust, which may block the trustee from following directions of the attorney-in-fact to make a charitable gift, absent express authority to follow such directions.

The Internal Revenue Service has ruled on a number of occasions that the holder of a general durable power of attorney has no authority to make gifts (typically, annual exclusion gifts to family members) out of assets to which the power pertains unless the power of attorney expressly authorizes the making of such gifts or applicable state law grants the holder of the power such authority.

*Gifts made out of the revocable living trust at the settlor's demise:* Amounts left to charity from a revocable living trust at the settlor's death normally qualify for the federal estate tax charitable deduction under IRC section 2055 because the amounts are included in the settlor's gross estate and are considered to be transferred to charity by the settlor.

Generally, any gift arrangement that can be established by will can be arranged under the terms of a revocable living trust, although there are some fine points to be observed in dealing with revocable living trusts that are to distribute assets to a charitable remainder trust.

*Distribution to a charitable remainder trust:* If assets are left from a revocable living trust to a charitable remainder trust, the federal income tax regulations require that the assets be transferred from the living trust to the charitable remainder trust (i.e., from the trustee of the former to the

trustee of the latter) so that the two trusts are separate and distinct. See Reg. section 1.664-1(a)(6), Example (4).

If the revocable living trust is to pay the settlor's debts, federal estate tax and any state death taxes, it is important that the distribution to the charitable remainder trust be net of the debts and taxes so that none of the debts and taxes are paid by the charitable remainder trust. See Reg. section 1.664-1(a)(6), Example (3).

Although the charitable remainder trust may not be funded by the revocable living trust immediately upon the settlor's death, the obligation of the charitable remainder trust to make payment of the annuity or unitrust amount should begin on the date of the settlor's death. In this regard, see Reg. section 1.664-1(a)(6), Example (4) (i) and 1.664-1(a)(5).

The charitable remainder trust will be deemed created once it is partially or completely funded. This is significant because distributions made by the charitable remainder trust and any undistributed income of the charitable remainder trust will be governed for tax purposes by IRC section 664 (meaning, for example, that any undistributed income of the charitable remainder trust will bypass federal income taxation by reason of the trust's exemption from federal income tax under IRC section 664(c)). Post-mortem distributions by the living trust to the beneficiary(ies) of the charitable remainder trust are not governed by the special rules of section 664, but rather by the usual rules governing trust distributions. See Reg. section 1.664-1(a)(6), Example 4(ii). See section 664 for rules concerning maximum and minimum payout rates and charitable remainder values.

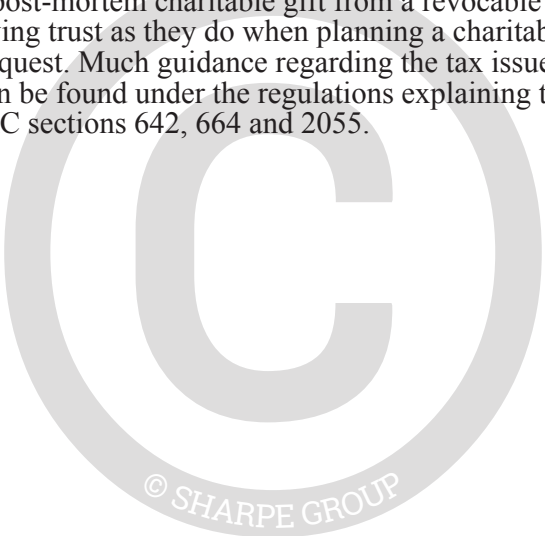
*Income in Respect of a Decedent (IRD) items:* If an individual plans to leave income in respect of a decedent to a revocable living trust at his or her death, it can make sense to use the IRD items to make charitable bequests. IRD left to an individual is generally subject to both federal income tax and federal estate tax. IRD

left to charity, on the other hand, bypasses both income tax (because of the charity's tax-exempt status) and estate tax for the charitable gift portion (because of the estate tax charitable deduction).

It is important, however, for the instrument creating the revocable living trust specifically to direct the IRD item(s) to charity, in order to be assured that the trust does not pay income tax on the IRD. For details, see Income Tax Reg. 1.642(c)-3(b)(2) and the corresponding regulations.

## **Conclusion**

Many of the same tax and drafting considerations come into play when planning a post-mortem charitable gift from a revocable living trust as they do when planning a charitable bequest. Much guidance regarding the tax issues can be found under the regulations explaining the IRC sections 642, 664 and 2055.



The purpose of this publication is solely educational, namely to provide general gift, estate, financial planning and related information. It is not intended as legal, accounting or other professional advice, and you should not rely on it as such. For assistance in planning charitable gifts with tax and other implications, the services of appropriate and qualified advisors should be obtained. Consult an attorney for advice if your plans require revision of a will or other legal document. Consult a tax and/or accounting specialist for advice regarding tax and accounting related matters. © Copyright MMXX by Sharpe Group. All Rights Reserved.



[This space as well as the front cover may be used for logo and other contact information.]