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Charitable Giving Techniques to Maximize an Estate Plan

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Philanthropic giving has become an increasingly popular cornerstone to estate planning. Whether clients choose to give specific sums to charities during life or at death, charitable giving allows individuals to fulfill their philanthropic goals on their own timelines and based upon their specific desires.

Aside from the monetary impact of charitable planning and philanthropic giving, proper structuring of a charitable gift may have significant tax benefits to the donor. A donor may deduct some or all of a charitable gift from taxable income in the year of the gift. At death, a charitable bequest is taxed at 0% for Pennsylvania inheritance tax purposes, and it is deductible for federal estate tax purposes so long as the governing instrument provides for the distribution to a charitable organization. Charitable giving is one of the only estate planning mechanisms that can be used to eliminate estate tax on an estate of any size.

Direct Gifts

Direct gifts to charitable organizations is the simplest and most efficient method of charitable giving. During life, a donor may give cash, marketable securities, tangible assets (such as art, antiques, etc.), or real estate. For donors older than age 70 1/2, retirement accounts may also be used, through a process called a qualified charitable distribution (QCD). QCDs allow a donor to donate directly from an IRA to a qualified charity, fulfilling the donor's required minimum distribution for that year and avoiding taxable income on such assets. A QCD is limited to $108,000 per donor for 2025.

When giving appreciated property to a charitable organization, a donor may avoid paying income tax when the appreciated asset is ultimately sold by the charitable organization. If a donor bequeaths property to a charitable organization at death, the donor may choose to give either a specific sum to a charitable organization or a percentage of the donor's estate. In both structures, the Attorney General of Pennsylvania, in its role as parens patriae, will supervise the administration of the donor's estate to assure that the bequest is paid.

At death, a donor may also choose to pay charitable beneficiaries out of nonprobate assets. Retirement accounts, for example, can be a tax-efficient source for paying charitable bequests. While retirement accounts are typically subject to income tax when individual beneficiaries receive distributions from a retirement plan, distributions are not subject to income tax when paid to charitable beneficiaries. By naming charitable organizations as beneficiaries of retirement accounts, income tax will be avoided upon the payment of the retirement benefits.

Donor Advised Fund

A donor advised fund (DAF) is a charitable giving vehicle in which a donor may make a current, irrevocable charitable gift but later advise as to the amount given to a charitable entity or entities, and the identities of the recipient charitable entity or entities. A donor creates a DAF with a financial institution and then deposits funds into the DAF so that the funds may be managed and hopefully grow. Every year, the financial institution is required to distribute funds from the DAF to a charitable entity or entities, but the donor may advise the custodian as to which charity or charities to pay each year and how much to pay to each charity. It is important to note that the custodian is not legally required to follow the advice of the donor.

From an income tax perspective, donors receive an immediate income tax deduction at the time of the gift to the DAF. The assets in the DAF can then be invested and potentially grow income tax-free. The custodian is responsible for the administration of the DAF, along with any tax filings. From the donor's perspective, once the donor contributes to the DAF, the donor's only role is to advise the custodian on potential investments, distributions amounts, and charitable beneficiaries. A DAF, however, cannot be used to fulfill a donor's pledge to a charitable organization. Ultimately, DAFs are great vehicles to use when a donor needs an immediate income tax deduction but is not quite sure as to how to distribute funds to a charity or charities.

Private Foundation

Unlike a DAF where a custodian manages the charitable fund, a private foundation is a charitable organization where an individual (usually the donor or the donor's family) manages every aspect of the charitable fund. Private foundations are overseen by a board of directors or trustees who are responsible for receiving charitable contributions, managing and investing assets, soliciting and making grants to other charitable organizations, and preparing the requisite tax filings. While creating and administering a private foundation is more complex than a DAF, a private foundation is best for someone who wants to have greater control over the management of funds and the execution of charitable goals.

Subject to limitations, contributions to a private foundation are deductible for federal income tax purposes. A foundation does not pay federal income tax, but it is subject to a federal excise tax on its net investment income. A private foundation is required to distribute 5% of its assets annually, and the failure to so distribute its assets could incur a penalty.

Creating a private foundation requires initial startup costs in order to acquire 501(c)(3) status from the Internal Revenue Service. Because of the startup costs and annual administration costs of running a private foundations, it is usually recommended that a private foundation be funded with a substantial initial contribution.

Charitable Remainder Trust

A charitable remainder trust (CRT) is a split interest trust which initially benefits a non-charitable beneficiary (usually the donor or the donor's family member) during the term of the CRT and benefits a charity at the conclusion of the CRT term. A CRT is similar to a grantor retained annuity trust, except the remainder beneficiary is a charity. During the term of the CRT, which can be for a specific term of up to twenty years or for the life of one or more beneficiaries, the non-charitable beneficiary receives either fixed annuity or unitrust payments. At the conclusion of the term, the charitable beneficiary receives the remaining assets in the CRT. The grantor's charitable gift to a CRT is therefore equal to the value of the remainder interest in the CRT.

The present value of the remainder interest is calculated using the applicable federal rate (AFR) in effect at the time the grantor makes a contribution to the CRT and will provide the grantor with a charitable deduction for both income and gift tax purposes. The remainder interest must equal at least 10% of the fair market value of the assets contributed to the trust. CRTs work best in high interest rate environments so that the value of the remainder interest, and therefore the charitable deduction, will be maximized.

Ideally, low-basis property should be contributed to a CRT. Since a CRT is not subject to income tax, income tax may be avoided through the sale of low-basis assets within a CRT.

Charitable Lead Trust

A charitable lead trust (CLT) is a split interest trust which initially benefits a charitable beneficiary during the term of the CLT and then benefits individuals upon the conclusion of the term. The initial term of the CLT may be for a specific term of years or the life of one or more individuals. The remainder beneficiaries are typically the donor's descendants or further trusts for the benefit of the donor's descendants. During the term of the CLT, the charitable beneficiary receives either regular annuity or unitrust payments. At the conclusion of the term, the individual beneficiaries receive the remaining assets.

The donor's gift to a CLT is a taxable gift by the donor to the extent of the value of the remainder interest. The value of the gift of the remainder interest is equal to the initial value of the contributed assets, reduced by the present value of the annuity or unitrust payments to the charity. A CLT can be structured to "zero out" at the end of the charitable term such that the value of the remainder interest is zero, thereby resulting in little or no gift tax. At the termination of the charitable term of a zeroed out CLT, any appreciation on the assets of the CLT during the term will pass to the remainder beneficiaries estate and gift tax free. A CLT therefore works best in low-interest rate environments, as any investment performance greater than the AFR at the time of creation of the CLT will pass estate and gift tax free to the remainder beneficiaries.

Charitable planning can have a powerful impact on an estate plan. Through various charitable planning techniques, individuals may be able to achieve their philanthropic goals while creating efficient tax strategies and structures.

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