MAKE YOUR CHARITABLE ESTATE PLAN GREAT AGAIN

Charitable Planning with Retirement Accounts: Strategies, Traps & Solutions

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TABLE OF CONTENTS

PART ONE - Income Tax Deductions for Charitable Bequests of IRD

Will an estate or trust get a charitable income tax deduction when IRD is donated to a charity?

I. Overview 2
- A. Worst case scenarios 2
- B. Best way to structure: pay IRD to charity, with charitable deduction as backup 2
- C. The economic effect regulation 3
- D. Strategies when the governing instrument has no provision for IRD 3

II. Charitable Income Tax Deduction More Challenging for Trusts & Estates 4
- A. Can the trust or estate claim a charitable income tax deduction ? 4
- B. Does there have to be an economic effect ? 4
  - 1. Overview 4
  - 2. Example with tax-exempt interest 5
  - 3. Example with taxable interest 5
  - 4. Examples with economic effect 6

III. Pecuniary Amounts to Charities Can Trigger Income Tax Problems 6

IV. Planning 7
- A. Two Ways To Structure Bequests of IRD 7
- B. Avoid Recognition of IRD 7
  - 1. Probate Assets -- In-Kind Distributions and Non-Pro Rata Distributions 7
  - 2. Retirement Accounts 8
- C. Draft the governing instrument to require IRD to be used for charitable bequests 8

V. When it is too late to plan 9
- A. Distribute IRD assets from the estate to charities 9
- B. Pay the charities last – get an income tax deduction 9

VI. Conclusion 9

VII. Addendum - Sample provision to insert in a governing instrument 10

PART TWO - Income-Based Charitable Bequests

I. Overview 11

II. Planning Charitable Bequests 11

III. Having the Conversation: Avoid the Word "Bequest" 12

IV. Will There be IRD Assets ? 12
- A. Avoid Income Recognition to the Estate from IRD Assets 13
- B. Charitable Income Tax Deduction to Offset IRD 14

V. Nontaxable Estates: Make Income-Based Charitable Bequests 14
- A. Will an Income-Based Bequest Qualify for a Charitable Income Tax Deduction? 15
- B. Charitable Income Tax Deduction for a Pecuniary Bequest 15
- C. Income Tax Savings to the Beneficiaries - Challenges from the Two-tier System 16

PART ONE - Income Tax Deductions for Charitable Bequests of IRD
Will an estate or trust get a charitable income tax deduction when income in respect of a decedent is donated to a charity?

I. Overview

A. Worst case scenarios

There is an increasing amount of income in respect of a decedent ("IRD") assets (principally in the form of IRAs and other retirement plan assets) in the estates of decedents. These assets trigger taxable income to the beneficiaries when they receive a payment. If an individual with a sizeable amount of IRD assets intends to make a charitable bequest, estate planners recognize that the IRD assets can be the most attractive property to fund the charitable bequest. If all goes well, the entire pre-tax amount of IRD can be transferred tax-free to a tax-exempt charity, and the gift will make a larger impact than if it had been reduced by income taxes.

But sometimes things don't go well. The worst-case scenario is that an estate or trust might have to recognize taxable IRD but will not be able to claim an offsetting charitable income tax deduction, despite the transfer to a charity. This can happen when IRD is payable to an estate or a trust whose governing instrument doesn't contain instructions that assure the offsetting charitable income tax deduction.[1] And, according to Private Letter Ruling 201438014 (May 5, 2014), it can also occur when IRA assets are used to satisfy a testamentary trust's *pecuniary* charitable bequest, even when payments are made from the IRA directly to the charity rather than to the trust. In that ruling, the Service also stated that it would not respect a probate court's reformation of the trust instrument. The Service concluded that it would look to the original governing instrument, rather than the reformed one, since the purpose of the reformation was to obtain favorable tax benefits for the charitable bequest rather than to resolve a conflict.

B. Best way to structure: pay IRD to charity, with charitable deduction as backup

What is the best way to structure a charitable bequest of IRD assets? And what mechanisms are available after a decedent's death either (a) to prevent an estate or trust from recognizing IRD or (b) to obtain an offsetting charitable income tax deduction when it has IRD?

Two steps should take place in the planning stage. First, the best results usually occur when IRD can be transferred to a charity or to a tax-exempt charitable remainder trust ("CRT") in such a way that the income is never recognized by the estate or trust. IRD is taxed to the person who is legally entitled to receive it. If a charity or CRT is entitled to receive the IRD, then it, rather than an estate or trust, should report the income. Estate planners should take steps to accomplish this. With retirement plan accounts, this is usually best achieved by naming the charity or the CRT as the beneficiary on the retirement plan beneficiary designation form. With IRD assets owned by an estate or trust, such as savings bonds or installment sale notes, the estate or trust can avoid recognizing income (a) if the governing instrument contains instructions to distribute these assets in-kind to a charity or to a CRT or (b) if the governing instrument, or state law, grants the trustee or the personal representative the power to distribute assets in a non-pro rata fashion among the multiple beneficiaries.

Second, every will and trust instrument should contain instructions that if the estate or trust will make a charitable bequest, then the estate or trust will make that payment first with IRD so that the estate or trust is entitled to a charitable income tax deduction. An example of such an instruction appears in the addendum to this article (Part VII). This will usually be a fallback strategy. It could prove helpful if a forgotten retirement account is payable to the estate, or if the individuals who were named as beneficiaries of a retirement account have died and the estate became the default beneficiary.

To facilitate tracing the IRD to the charitable distribution, cautious administrators might consider establishing a separate checking account to receive IRD payments, such as distributions from retirement accounts. Charitable distributions made from such an account were clearly made with IRD.

The instructions should also be drafted to generate a charitable income tax deduction in case appreciated property is used to satisfy a pecuniary bequest (that is, appreciated property is used to satisfy a fixed dollar payment to a charity). The sample provision in the addendum to this article contains such an instruction (see Part VII).

Every case or ruling that denied a charitable income tax deduction involved an estate or trust that was missing such instructions. Since IRD can be taxed twice to an estate (once on the estate's federal estate tax return and again on the estate's income tax return), an estate or trust should be entitled to claim two charitable tax deductions (both estate tax and income tax) when IRD is transferred to a charity.

C. The economic effect regulation

A 2012 tax 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."[2] The regulation has raised questions about using a clause that provides, oversimplified, "if there are any charitable bequests, pay them first out of IRD, if any." That clause does not have an economic effect since the charity will receive the full bequest amount regardless of how much or how little IRD is in an estate.

As will be explained below, the "economic effect" regulation merely regulates the tax characteristics of the income transferred to a charity (interest income, dividend income, etc.). It does not prevent an estate or trust from claiming a charitable income tax deduction. But it can cause the amount of the charitable income tax deduction to be less than the amount of the IRD that was transferred to the charity, if the estate or trust had tax-exempt income, such as interest from municipal bonds.

D. Strategies when the governing instrument has no provision for IRD

What options are available if a retirement account is payable to an estate or trust whose governing instrument doesn't contain provisions that would produce an offsetting charitable income tax deduction? There are ways to avoid an income tax burden, particularly when charities are the beneficiaries of the *residue* of the estate. First, if the governing instrument permits non-pro rata distributions of assets, there are several private letter rulings that permit an estate or trust to "distribute" the retirement account to a charity and thereby avoid recognizing income. However, PLR 201438014 suggests that this arrangement might not work if a charity will receive a fixed dollar amount. Second, it may be possible for an estate to obtain an offsetting charitable income tax deduction by delaying receipt of retirement distributions until the charitable beneficiaries are the sole remaining beneficiaries of the estate.

II. Charitable Income Tax Deduction More Challenging for Trusts & Estates

A. Can the trust or estate claim a charitable income tax deduction ?

Whereas an individual can easily claim an income tax deduction for virtually any charitable contribution of cash or property,[3] the rules are more restrictive for an estate or trust. In order for an estate or trust to claim a charitable income tax deduction, Section 642(c) requires that the payment of income to the charity should be made pursuant to the terms of the governing instrument.[4]

The payment to the charity must be traced to income.[5] An estate or trust is normally not entitled to claim a charitable *income* tax deduction for the payment of a charitable bequest.[6] A typical charitable bequest is a charitable disposition of property that the decedent owned on the date of death. By comparison, an estate's income is usually earned after the decedent's death. Thus a charitable bequest is usually deducted only on an estate's federal estate tax return and not on the estate's federal income tax return. On the other hand, IRD (which is income earned before the decedent's death) can be reported on *both* the estate tax return and the estate's income tax return. Consequently, a charitable bequest of IRD is the unique charitable bequest that could produce a charitable tax deduction on *both* the estate tax return and the estate's income tax return.

Only a *charitable* income tax deduction can generate the income tax deduction that can offset the IRD that might be reported on an estate's or trust's income tax return. Whereas an estate or trust can usually claim an income tax deduction for a distribution of income ("distributable net income, or "DNI") to a beneficiary, there is no DNI deduction when that beneficiary is a charity.[7] It has to be a charitable deduction.

The possibility of a harsh outcome is illustrated in a 2008 IRS Chief Counsel Memorandum.[8] A trust was denied a charitable income tax deduction after it received taxable IRA distributions and then distributed the amounts to charities. The IRS Chief Counsel's office concluded that the trust had taxable income from the IRA distribution but was not entitled to claim an offsetting charitable income tax deduction since the trust instrument contained no instructions to distribute income to a charity.

On the other hand, when a governing instrument contains instructions to distribute income to a charity, then it is possible for an estate or trust to claim a charitable income tax deduction on both the estate tax and the income tax return when income attributable to the IRD is distributed to a charity.[9] Estate planners should consider including a provision in every will and trust instrument that if an estate or trust will make a charitable bequest, then that payment will be made first with IRD.

B. Does there have to be an economic effect ?

1. Overview

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."[10] That regulation governs the *character* of the income distributed to a charity from a trust's or estate's charitable income tax deduction, not whether an estate or trust is eligible to claim a deduction at all.[11] But the regulation can cause the amount of the deduction to be less than the amount of IRD transferred to the charity.

2. Example with tax-exempt interest

For example, assume that a trust instrument provides for a bequest to a charity of $100,000. The trust's governing instrument states, oversimplified, "pay my charitable bequests first from IRD, if any." Assume that the trust collected $20,000 from an IRA distribution (which is IRD) and that the trustee even went the extra step of depositing the amount into a separate checking account. The trustee distributes the $20,000 to a charity and pays the remaining $80,000 to the charity from the main checking account. The only other income that the trust received was $20,000 of qualified dividend income (eligible for a low 15%/20% tax rate) and $10,000 of tax-exempt interest. The trust then distributes $30,000 to the only non-charitable beneficiary of the trust, the decedent's daughter.

The language "pay my charitable bequests first from IRD, if any" does not have an economic effect since the charity was entitled to receive $100,000 regardless of the amount of IRD that the trust collected. This does not prevent an estate or trust from claiming a charitable income tax deduction. Instead, the consequence of an absence of an economic effect is that the *character* of the income distributed to the charity and to the beneficiary "is deemed to consist of the same proportion of each class of the items of income of the estate or trust as the total of each class bears to the total of all classes."[12] Thus, the charity's $20,000 and the daughter's $30,000 are each deemed to be 40% IRA income (taxed at ordinary rates, but exempt from the 3.8% net investment income surtax[13]), 40% dividends and 20% tax-exempt interest. The trust can claim a $16,000 charitable income tax deduction[14] (there is no deduction for the tax-exempt interest)[15] and a $24,000 DNI deduction to offset the $40,000 of taxable income. Thus, even though the $20,000 of IRD was physically delivered to the charity, the offsetting charitable income tax deduction is only $16,000.

3. Example with taxable interest

Assume that in the preceding example the $10,000 of interest had been taxable interest rather than tax-exempt interest. The trust would have received $50,000 of taxable income rather than just $40,000. In that case, the trust could can claim a $20,000 charitable income tax deduction and a $30,000 DNI deduction to offset the $50,000 of taxable income.

The $20,000 of IRD that was physically delivered to the charity generates a $20,000 offsetting charitable income tax deduction. But because the instructions did not have an economic effect, the *character* of the $20,000 of income paid to the charity will not consist solely of IRD. Instead, the charity's $20,000 and the beneficiary's $30,000 are each deemed to be 40% IRA income, 40% dividends and 20% taxable interest.

4. Examples with economic effect

a. Pay all IRD to a charity

If there had been an economic effect to the instructions, then the IRD payment to the charity would retain its character as IRD. For example, assume that there is no charitable bequest except that the trust instrument states "pay all of the IRD that is ever collected to Charity XYZ." The clause has an economic effect because the amount that the charity will receive from the trust will vary depending on how much IRD the trust collects.

In that case, the character of the charity's income is 100% IRD and none of the other income of the trust will be deemed to be distributed to the charity.[16] This arrangement can affect the amount and the character of the income that is paid to the non-charitable beneficiary or is retained by the trust.[17] In the above example, if 100% of the IRD is paid to the charity, then the beneficiary's $30,000 of income would consist of $20,000 of dividends and $10,000 of interest.

And, of course, if the charity had simply been named as the beneficiary of the IRA, then the trust would have had no IRA income. All of the IRA income would instead be reported by the charity, since it had the legal right to receive the income from the IRA. In that case, if the trust only received $20,000 of dividend income and $10,000 of tax-exempt interest that it distributed to the daughter, she would have only been taxed on the $20,000 of dividend income instead of $24,000 of both dividend and IRA income. If there had been $10,000 of taxable interest instead of tax-exempt interest, the beneficiary would report $20,000 of dividend income and $10,000 of taxable interest.

b. Pay IRD to a charity, but with a dollar limit

A similar outcome may apply when a dollar limit is imposed. Suppose, for example, that a trust instrument states "pay the first $20,000 of retirement plan distributions that this trust receives to Charity LMN." The instructions have an economic effect, since the trust (and therefore the charity) might receive less than $20,000 if the trust receives insufficient retirement plan distributions.[18] Applying this scenario to the facts in the above example, if $20,000 of the IRD is paid to the charity, then the other beneficiary's $30,000 of income would consist of $20,000 of dividends and $10,000 of interest.

III. Pecuniary Amounts to Charities Can Trigger Income Tax Problems

The tax problems can be compounded if a trust instrument or a will contains a fixed-dollar ("pecuniary") charitable bequest. This was the case in PLR 201438014, when the trust instrument provided that two charities would each receive a pecuniary amount.

The tax regulations state that when 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.[19] For example, if a nephew is entitled to a $100,000 inheritance and the estate satisfies this obligation by distributing to the nephew publicly-traded stock worth $100,000 but with a tax basis of just $80,000, then the estate has a taxable gain of $20,000. Somebody will have to pay the tax on that income. Either the estate or, if the capital gain is distributed to the nephew, the nephew.

The same taxable gain can be triggered if appreciated property is used to satisfy a pecuniary obligation to a charity. For example, if a charity is entitled to a $100,000 charitable bequest and the estate satisfies this obligation by distributing to the charity publicly-traded stock worth $100,000 but with a tax basis of just $80,000, the estate has a taxable gain of $20,000.

But there is a difference when the beneficiary is a charity instead of a nephew. When the beneficiary is a charity, the estate might be able to claim a $20,000 charitable income tax deduction under Section 642(c) that could fully offset the taxable gain. The IRS approved such an offsetting charitable income tax deduction in Revenue Ruling 83-75.[20] In that ruling, a charitable lead trust recognized taxable gain after it distributed appreciated stock to a charity to satisfy its charitable payment obligation for the year. The IRS concluded that the trust was entitled to claim an offsetting charitable income tax deduction under Section 642(c).

In order to claim such an offsetting charitable income tax deduction, the governing instrument should contain instructions to distribute income to charity. Charitable lead trusts always contain such instructions. The outcome when there are no such instructions is illustrated in PLR 201438014. The Service concluded that if IRA assets were used to satisfy pecuniary obligations to two charities, the trust would be required to treat the payments as sales or exchanges, thereby triggering taxable income. And since the trust instrument did not "direct or require the trustee pay the *pecuniary* legacies from [the] Trust's gross income," the trust would not be entitled to claim a charitable income tax deduction to offset the taxable income. The Service had reached a similar conclusion in a 2006 Chief Counsel Memorandum.[21]

The ruling illustrates how useful it can be to insert a provision in the governing instrument to pay charitable bequests with income from IRD and also with income generated by satisfying pecuniary obligations. The sample provisions contained in the addendum to this article (Part VII) contain such instructions.

Can a trust instrument or a will without such language be reformed? In PLR 201438014, the Service rejected a probate court's reformation of the trust instrument to try to obtain the charitable tax deduction since the purpose of the reformation was to obtain favorable tax benefits rather than to resolve a conflict. Consequently, the impact of good planning and drafting at the outset is very important.

IV. Planning

A. Two Ways To Structure Bequests of IRD

How should testamentary transfers of IRD to charities be structured? There are basically two ways to structure a charitable bequest of IRD. The first is to have the IRD paid directly to a charity so that the charity, rather than an estate, trust or a beneficiary, recognizes all of the IRD. If the estate or trust never recognizes any IRD, there is no need for it to claim an offsetting charitable income tax deduction.

The second way is to have an estate or trust receive the taxable IRD and then claim an offsetting charitable income tax deduction when the IRD is distributed from the estate or trust to the charity. Estate planners should include a provision in every will and trust instrument that if the estate or trust will make a charitable bequest, then that payment will be made with IRD.

The first method is usually superior. The administration of the trust or estate is simpler if the income from the IRD is never recognized on the trust's or estate's income tax return. As PLR 201438014 illustrates, this second strategy should only be undertaken if the estate planner is confident that such an offsetting deduction will be assured.

B. Avoid Recognition of IRD

How can IRD not be reported on an estate's or trust's income tax return? The answer depends on the nature and source of the IRD. For IRD assets that would normally go through probate, the governing instrument can instruct or permit the assets to be donated to charity. For retirement accounts, the beneficiary designation form used by the retirement plan is more important than a will or trust.

1. Probate Assets -- In-Kind Distributions and Non-Pro Rata Distributions

If the IRD is generated by the type of asset that normally goes through probate -- such as savings bonds,[22] an employee stock option,[23] or an installment sale note, then the solution can be an in-kind distribution of those assets to a charity. The governing instrument can specify that those assets should be donated to a charity. The same favorable outcome can occur when the governing instrument, or state law, grants the trustee or the personal representative the power to distribute assets in a non-pro rata fashion among the multiple beneficiaries.[24]This permits the transfer of pre-tax IRD assets to tax-exempt charities, and the transfer of step-up basis stock and other property to tax-paying beneficiaries. When the charity or CRT collects the savings bond interest or receives taxable payments on the installment sale note, then it, rather than the estate or trust, has the taxable income.

2. Retirement Accounts

The largest amounts of IRD are held in retirement accounts, which are trusts or custodial accounts that usually have their own beneficiary designations. Distributions from retirement accounts to beneficiaries pass outside of probate. Usually the estate recognizes no income from such distributions, unless the estate was designated as the beneficiary of the account and actually received the distributions.

Consequently, the best way to transfer the IRD in a retirement plan account to a charity is for the plan participant or the IRA owner to have named the charity as the beneficiary of some or all of the retirement account on the beneficiary designation form provided by the plan administrator.[25] In that case, the retirement account will make a payment directly to the charity and will inform the charity that it has received taxable income. The tax-exempt charity, of course, does not pay income tax upon the receipt of the distribution. This is the case even for a private foundation that must normally pay a 1% or 2% excise tax on its investment income.[26]

Under this arrangement, the estate or trust will not report any income when the retirement account makes a payment to the charity. [27] Since the estate or trust never recognizes any income, there is no need for an offsetting charitable income tax deduction. This strategy also works with other forms of IRD where a person has the ability to designate a beneficiary, such as a bequest of an interest in a nonqualified deferred compensation plan[28] or of a taxable death benefit under an annuity contract.

C. Draft the governing instrument to require IRD to be used for charitable bequests

As was demonstrated above, every case or ruling that denied a charitable income tax deduction to an estate or trust when IRD was in fact distributed to a charity involved an estate or trust whose governing instrument made no mention of distributing income to a charity. Unless there are post-mortem strategies that can salvage income tax savings (a few are described below), an estate or trust can pay income tax on charitable bequests that were funded with IRD.

Consequently, there is no harm inserting instructions in every will and trust instrument that if the estate or trust will make a charitable bequest, then that bequest will be made by the estate or trust with IRD in a manner that entitles the estate or trust to a charitable income tax deduction. Even wills and trusts that make no charitable bequests can contain such instructions, since a charitable bequest might later be added by a codicil. An example of such instructions is in the addendum to this article.

If the governing instrument provides that income (including IRD [29]) will be distributed to charity, then the estate or trust is entitled to a charitable income tax deduction for the income that it distributes to the charity.[30] Even in PLR 201438014, the Service concluded that if the governing instrument had instructed the *pecuniary* bequests to be paid with IRD, it could have been eligible for a charitable income tax deduction.[31]

But the Service also concluded that it would not respect a probate court's reformation of a trust instrument where the sole purpose was to obtain favorable income tax benefits. It is best to get things right while the individual is still alive. When it is too late, there may still be some tax-saving options.

V. When it is too late to plan

After an individual dies, it is too late to prepare a new governing instrument. If an estate or trust will receive IRD, what techniques are available for the estate or trust to avoid paying income tax when the IRD will be paid to a charity and there are no instructions in the governing instrument to distribute income to a charity? There are private letter rulings that offer relief, particularly when charities are the residual beneficiaries of an estate.

A. Distribute IRD assets from the estate to charities

Under some circumstances, there is a way for the taxable income from a retirement account to be diverted from an estate to a charity, even when the estate was named as the beneficiary of the account. There are many IRS rulings that permit an estate or a trust to "distribute" such a retirement account to a charity, just as it might make a distribution of a particular stock or a parcel of land to a beneficiary. In most of the rulings, the charity was the residual beneficiary of the estate or trust and the governing instrument (or the law of the state) permitted non-pro rata distributions of assets among multiple beneficiaries. Neither the estate nor any other beneficiary would have to report any taxable income when the distributions were made to the charities.[32]

B. Pay the charities last – get an income tax deduction

Another strategy is to pay the charities last. This works best when the residue of the estate will be paid to charities following specific bequests to individuals. Assume, for example, that an individual named his estate as the beneficiary of his IRA. In Year 1, the executor could pay most administrative expenses and all of the specific bequests to the individuals, leaving the charity as the only remaining beneficiary at the end of Year 1. Then in Year 2 the estate could receive the entire IRA and distribute those proceeds and all of the estate's remaining assets to the charities. Under these facts, the IRS concluded that an estate was entitled to a charitable set-aside income tax deduction that would offset the taxable income from the IRA.[33]

VI. Conclusion

The best way to structure charitable bequests of IRD is to shift the income to the tax-exempt charity and away from the taxable estate or trust. That way there is no need for an estate or trust to claim a charitable income tax deduction. Shifting the income is best accomplished by naming charities as beneficiaries of retirement plan accounts and by authorizing a trustee or personal representative to make non-pro rata distributions among the beneficiaries.

As a back-up plan in case an estate or trust will have IRD, a trust instrument or a will should contain directions that any charitable bequests will be paid, to the extent possible, with IRD. The harsh outcomes that occurred when estates and trusts received taxable IRD payments that they distributed to charities, but were denied an offsetting charitable income tax deduction, all took place in situations where the governing instruments did not contain such directions.

VII. Addendum - Sample provision to insert in a governing instrument

Here is boilerplate language that can be added to a will or trust instrument to entitle an estate or trust to claim a charitable income tax deduction when satisfying a charitable bequest with IRD or with appreciated property. Caution and disclaimer: to date such a provision has not appeared in any reported court case or IRS ruling.

Pay Charitable Bequests with IRD and Other Taxable Gross Income. 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), and second with any 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.

** Alternatively, specific conflicting provisions may be identified: "Except as otherwise provided in [Sections] [Articles] [Paragraphs] __________,"*

Drafter's comment: This provision is intended to take precedence over any general provision in the governing instrument or under state law (including the Uniform Principal and Income Act), such as the traditional policy that capital gains are to be retained by a trust or an estate rather than distributed to a beneficiary. If, however, there is a specific conflicting provision in the governing instrument, then such conflicting provision will control over this provision. Common examples of conflicting provisions include instructions that:

* retirement plan distributions that are received by a trust may only be paid to "designated beneficiaries" after a specified date (such as September 30 following the year of death),

* all of a trust's [or estate's] income in respect of a decedent should be paid to a single charity, and

* income shall be allocated to a surviving spouse in such a manner that a trust or estate may claim a marital estate tax deduction on a federal estate tax return.

When administering a trust or estate, rather than commingle IRD receipts with other cash receipts, it may be advisable to establish a separate checking account whose sole function is to receive deposits of IRD and to make the charitable distributions. This can strengthen the argument that the fiduciary is carrying out the instructions in the governing instrument and that IRD was in fact distributed to a charity.

PART TWO - Income-Based Charitable Bequests

I. Overview

Charitable bequests are usually viewed as providing estate tax savings but no income tax savings. Actually, the traditional charitable bequest represents a lost income tax saving opportunity. If properly structured, every charitable bequest can reduce the income tax liability of a trust, an estate, or their beneficiaries.

Income tax savings can be achieved with income-based charitable bequests. One strategy is to move charitable bequests to the income section of the governing instrument. This is a wholesale change from the way that charitable bequests have traditionally been drafted. 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."

Instead, the charitable bequest could be drafted in the governing instrument's instructions pertaining to income. For example: "All of this estate's [trust's] income 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]." 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. In the simplest case, this arrangement could generate a charitable income tax deduction to offset the income generated during the typical administration of an estate.

This arrangement can be particularly advantageous for a nontaxable estate (an estate that is not subject to the federal estate tax). For the rare taxable estate (in the year 2017, an estate of someone, typically unmarried, valued at over $5.49 million), an estate planner should balance the tradeoff between estate tax savings and income tax savings from a charitable deduction. But, as will be demonstrated below, taxable estates may be able to achieve *both* estate tax and income tax savings with charitable bequests of income in respect of decedent ("IRD").

II. Planning Charitable Bequests

Income tax savings from charitable bequests can be achieved by following three guiding principles. First, an individual will generally achieve greater tax savings by making a lifetime charitable gift rather than a charitable bequest. It would be helpful if estate planners informed donors of this principle when they learn that a client is considering a charitable bequest. Whereas a bequest usually only produces an estate tax saving, a lifetime gift can generate a charitable income tax deduction, thereby producing a tax refund during the donor's lifetime. And with a deferred charitable gift, such as a charitable remainder trust ("CRT"), the donor can obtain a charitable income tax deduction during his or her lifetime even though the charity will not receive the assets until after the donor's death. In the meantime, the donor receives a steady stream of payments over his or her remaining lifetime.

For taxpayers who intend to make a charitable bequest, income tax savings can be obtained by identifying and using the best tax-saving assets for the charitable bequest, and by drafting the governing instrument to obtain income tax savings. Thus, the second guiding principle is to make charitable bequests with assets that generate IRD. These are assets that generate taxable income when the beneficiary receives a payment. Section 691(a). The strategy is to shift the inflated-value pre-tax IRD assets to tax-exempt charities, thereby permitting a larger amount of tax-free assets that have a stepped-up tax basis to go family members and friends. IRD assets include Series EE savings bonds and employee stock options, but by far the most prevalent source of IRD is an inherited retirement plan account. Rev. Rul. 92-47, 1992 -1 C.B. 198.

The third guiding principle is to draft the will or trust instrument in such a way that the estate or trust, and its beneficiaries, can get income tax savings from the charitable transfers made by the estate or trust. There are basically two drafting concerns to achieve this objective. The first is to qualify for a charitable income tax deduction. In order to claim a charitable income tax deduction, an estate or trust must generally have instructions in the governing instrument to distribute income to charity. Section 642(c)(1). For both a taxable estate (an estate that will incur a federal estate tax liability) and a nontaxable estate, there can be provisions in the governing instrument that charitable bequests should be paid with the trust's or estate's IRD so that the trust or estate can claim a charitable income tax deduction that offsets the IRD. And then, particularly for a nontaxable estate (the overwhelming majority of estates), income tax savings can be achieved by moving all charitable bequests to the governing instrument's instructions pertaining to income, as described above.

But it is not enough for a trust or an estate to be able to claim a charitable income tax deduction. The second drafting concern is that there are hurdles that might prevent the non-charitable beneficiaries from getting income tax savings from the estate's or trust's charitable income tax deduction. As will be explained below, under the two-tier system for taxing non-charitable beneficiaries of a trust or an estate, the best outcome will usually occur when all non-charitable beneficiaries are "tier-two beneficiaries." A tier-one beneficiary receives no tax benefit from a charitable income tax deduction claimed by a trust or estate.

III. Having the Conversation: Avoid the Word "Bequest"

Although estate planners routinely use the term "charitable bequest" in conversations amongst themselves, empirical evidence demonstrates that the term "bequest" is a turn-off to many clients. It reminds them of their own mortality. The desire to avoid death-related topics can discourage people from preparing and executing essential documents, let alone discourage them from considering a charitable disposition that they might otherwise be interested in making. The research found that the statement that generated the most interest in making a charitable disposition was: "many people like to leave a gift to a charity in their will." By comparison, clients were less interested in such a gift when asked if they wanted to "make a charitable bequest," "make a charitable gift that will take effect after your death," or "leave a legacy." See James, Russell N., *Phrasing the Charitable Bequest Inquiry* (November 8, 2014), available at SSRN: https://ssrn.com/abstract=2520973 , which surveyed over 5,700 individuals, This article will still use the term "charitable bequest" since the article is intended for estate planners. The main point in mentioning this research is to sensitize estate planners about the impact that their choice of words has on their clients.

IV. Will there be IRD Assets ?

For both taxable and nontaxable estates, the greatest tax savings will be achieved if pre-tax IRD assets can be used to satisfy charitable bequests. There are basically two ways to structure a charitable bequest of IRD. The first is to have the IRD paid directly to a charity so that the charity recognizes all of the IRD, rather than an estate, a trust or a beneficiary. If the estate or trust never recognizes any IRD, there is no need for it to claim an offsetting charitable income tax deduction.

The second way is for an estate or trust to receive taxable IRD and then claim an offsetting charitable income tax deduction when the IRD is distributed to the charity. If a charitable bequest is contemplated, attorneys should consider adding a provision to the will or trust instrument that instructs the fiduciary to pay the charitable bequest to the maximum extent possible with the estate's or trust's IRD, thereby entitling the estate or trust to claim a charitable income tax deduction under Section 642(c).

The first method is usually superior. The administration of the trust or estate is simpler if the income from the IRD is never recognized on the trust's or estate's income tax return.

A. Avoid Income Recognition to the Estate from IRD Assets

How can IRD not be reported on an estate's or trust's income tax return? The answer depends on the nature and source of the IRD. For IRD assets that would normally go through probate, the governing instrument can require or permit the assets to be donated in-kind to a charity. For example, a charity (rather than the estate or trust) reports taxable interest income when it redeems inherited savings bonds. Rev. Rul. 80-118, 1980-1 C.B. 254 and PLR 9845026 (August 11, 1998). The same outcome applies to a charitable bequest of employee stock options. PLRs 200002011 (Sept. 30, 1999) and 200012076 (Dec. 29, 1999).

For retirement accounts, the beneficiary designation form of the retirement plan is usually more important than a will or trust. The best way to transfer the IRD of a retirement plan account to a charity is for the plan participant or the individual retirement account ("IRA") owner to name the charity as the beneficiary of some or all of the retirement account on the beneficiary designation form provided by the plan administrator. In that case, the retirement account will make a payment directly to the charity and will inform the charity that it has received taxable income. Under this arrangement, the estate or trust will not report any income when a distribution is made from the retirement account to the charity. PLRs 200826028 (Mar. 27, 2008), 200652028 (Sep 13, 2006), 200633009 (May 16, 2006), 200618023 (Jan 18, 2006), 9723038 (March 11, 1997) (public charity); PLRs 9838028 and 9818009 (private foundation).

The tax-exempt charity, of course, does not pay income tax upon the receipt of the distribution. This is the case even for a private foundation that must normally pay a 1% or 2% excise tax on its investment income. PLRs 200425027 (Feb 27, 2004) and 9826040 (March 30, 1998). By comparison, if the IRD consists of interest from savings bonds or an annuity contract the 1%/2% excise tax does apply. Rev. Rul. 80-118, 1980-1 C.B. 254 (savings bonds) and Private Letter Ruling 200425027 (Feb 27, 2004) (annuity contract).

Under some circumstances, it is possible for the taxable income from a retirement account to be diverted from an estate to a charity, even when the estate was named as the beneficiary of the account. There are many IRS rulings that permit an estate or a trust to "distribute" such a retirement account to a charity, just as it might make a distribution of a particular stock or a parcel of land to a beneficiary. See, for example, PLRs 201444024 (March 24, 2014) and 201330011 (March 5, 2013). In most of the rulings, the charity was the residual beneficiary of the estate or trust and the governing instrument (or the law of the state) permitted non-pro rata distributions of assets among various beneficiaries. Neither the estate nor any other beneficiary would report any taxable income when the distributions were made from the retirement accounts to the charities.

B. Charitable Income Tax Deduction to offset IRD

In many cases IRD might not be diverted to a charity but might instead be recognized by a trust or estate. An example is a forgotten retirement plan account where no beneficiary was named, and the default beneficiary is the probate estate. In anticipation of such a situation, a will or trust instrument that contains a charitable bequest could have instructions that the bequest should be paid first with IRD, thereby entitling the estate or trust to claim a charitable income tax deduction under Section 642(c).

The IRS should respect such an instruction. A recent illustration appears in PLR 201611002 (Dec, 7, 2015). An individual owned several IRAs at the time of his death, each of which named his trust as the sole designated beneficiary. A provision in the trust instrument stated that his "IRAs shall be distributed to Foundation." The ruling stated: "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."

There appears, however, to be some confusion among estate planners whether a trust or estate can claim a charitable income tax deduction if the instruction to distribute IRD to a charity has no economic effect. A 2012 tax regulation provides that when a governing instrument identifies a specific source of income (such as IRD) to be used for a charitable distribution, the provision will control only if it has an "economic effect independent of income tax consequences." Treas. Reg. Section 1.642(c)(3)(b)(2). Thus, for example, a clause that states "pay $20,000 to the Charity and pay it first out of IRD, if there is any" does not have an economic effect since the charity will receive $20,000 regardless of how much or how little IRD is recognized by the estate.

To clarify, the economic effect regulation does not prevent an estate or trust from claiming a charitable income tax deduction. Instead, the regulation merely regulates the tax characteristics (interest, dividend, etc.) of the income that is transferred to a charity or retained by the trust. In the above example, if $20,000 of IRD was in fact distributed to a charity, the estate could be entitled to a $20,000 charitable income tax deduction, but the $20,000 payment would be recharacterized to represent a pro-rate share of that year's interest, dividend, IRD and other income. An examination of the economic effect regulation and its impact on charitable bequests of IRD can be found at Hoyt, Christopher R., *Income Tax Deductions for Charitable Bequests of IRD* (September 24, 2015), available at SSRN: https://ssrn.com/abstract=2665128 .

V. Nontaxable Estates: Make Income-Based Charitable Bequests

If an estate will not be subject to a federal estate tax, then instead of having instructions that only mention IRD, substantial tax savings can be achieved by requiring all forms of taxable income of an estate or trust to be first distributed to charitable beneficiaries. For example: "All of this estate's income shall be distributed to the Charity. If the cumulative amount of income of this estate exceeds $50,000, then Charity shall receive only a cumulative amount of $50,000 and all excess income may be retained or distributed to my beneficiaries at the discretion of the executor." Such a provision would thereby distribute to charities the first $50,000 of taxable income, *including* any income generated by IRD and (as will be described below) any income from satisfying a pecuniary charitable bequest with appreciated property.

Such a provision is well suited for distributing income earned during the administration of a probate estate, especially when the anticipated amount of income exceeds the amount of the charitable bequest. It is also well suited for a short-term trust whose purpose is akin to probate administration.

However, such a clause might not be appropriate for an estate that will be subject to the 40% federal estate tax and/or a state's estate tax. The estate planner should consider the relative benefits gotten from claiming a charitable estate tax deduction versus the tax savings on the income tax return, particularly if the estate's income could be distributed to beneficiaries who are in a lower income tax bracket than the estate or trust.

A. Will an Income-Based Bequest Qualify for a Charitable Income Tax Deduction?

The first threshold is to assure that a charitable distribution qualifies for a charitable income tax deduction. Section 642(c) provides that an estate or trust is entitled to a charitable income tax deduction for "any amount of the gross income, without limitation, which pursuant to the terms of the governing instrument is, during the taxable year, paid" to an eligible charity.

Charitable distributions must be traced to income. A typical charitable bequest of corpus will not qualify for a charitable income tax deduction. *Mott v. United States*, 462 F.2d 512 (Ct. Cl. 1972). Furthermore, whereas an estate or trust may deduct distributions of income to most beneficiaries as a distribution of distributable net income ("DNI"), this does not apply to charities. When the beneficiary is a charity, then the tax deduction must be claimed as a charitable income tax deduction under Section 642(c) and not as a distribution to a beneficiary of DNI. Treas. Reg. Section 1.663(a)-2; *United States Trust Co. v IRS*, 803 F.2d 1363 (5th Cir. 1986).

B. Charitable Income Tax Deduction for a Pecuniary Bequest?

When drafted broadly enough, an income-based charitable bequest should generate a charitable income tax deduction that encompass all forms of an estate's or a trust's taxable income. The deduction could, therefore, offset a taxable gain triggered by satisfying a pecuniary charitable bequest (that is, a fixed dollar charitable bequest) with appreciated property or with retirement assets.

By way of background, when 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). For example, if a niece is entitled to a $100,000 inheritance and the estate satisfies this obligation by distributing to the niece publicly-traded stock worth $100,000 but with a tax basis of just $70,000, then the estate has a taxable gain of $30,000. The same taxable gain can be triggered if appreciated property is used to satisfy a pecuniary obligation to a charity. The IRS asserted that such a gain occurred when retirement assets were used to satisfy a pecuniary charitable bequest. PLR 201438014 (May 5, 2014).

But there is a difference when the beneficiary is a charity instead of a niece. Whereas a niece pays income tax, a charity is tax-exempt. It is possible for an estate in such a situation to claim a $30,000 charitable income tax deduction under Section 642(c) that could fully offset its taxable gain, and then for the tax-exempt charity to avoid paying income tax upon receipt of such income. The IRS approved such an offsetting charitable income tax deduction in Revenue Ruling 83-75, 1983-1 C.B. 114 when a charitable lead trust recognized taxable gain after it distributed appreciated stock to a charity to satisfy its charitable payment obligation for the year.

Whereas a charitable lead trust has instructions in the governing instrument to distribute income to charity, such instructions are currently missing from most trust instruments. PLR 201438014 demonstrates what happens in such a situation. There, the IRS concluded that the trust would have to bear the income tax burden from having IRAs satisfy its pecuniary obligations to charities. The IRS also rejected a state court order that reformed the trust in a manner that would have produced a favorable income tax outcome. If the trust instrument had originally been drafted to include income-based charitable bequests, it should have been entitled to claim an offsetting charitable income tax deduction.

C. Income tax-savings to the beneficiaries - challenges from the two-tier system

It is not enough for a trust or an estate to be able to claim a charitable income tax deduction. There are hurdles that might prevent the non-charitable beneficiaries from getting income tax savings from a trust's or estate's charitable income tax deduction. For example, if the governing instrument of either a trust or an estate mandates annual distributions of income to a beneficiary, then that beneficiary will usually *not* get any income tax savings from the charitable income tax deduction.

By way of background, the income of a trust or estate is taxed to non-charitable beneficiaries under a two-tier system. 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). This can occur when the governing instrument mandates that a beneficiary receive annual distributions of income or a fixed dollar annuity payment from income. All other non-charitable beneficiaries who receive distributions are tier-two beneficiaries. Section 662(a)(2). For example, a beneficiary who might receive discretionary amounts of income or corpus is a tier-two beneficiary.

The Tax Court concluded that the charitable income tax deduction is an "intermediate tier" between tier-one and tier-two. Consequently, only tier-two beneficiaries receive a tax benefit from a charitable income tax deduction claimed by an estate or trust. Tier-one beneficiaries receive no income tax benefit from a charitable income tax deduction that is claimed by an estate or trust. The Tax Court stated:

"Section 662(a) is structured so that first-tier beneficiaries do not benefit from the charitable deduction.... In effect, the section 642(c) charitable distribution is an "intermediate tier" between tier-one and tier-two beneficiaries. We say intermediate tier because section 662(a)(2) is designed so that tier-two beneficiaries benefit from the section 642(c) charitable distribution deduction: the pool of potentially taxable income for determining the amount of a distribution that is taxable to tier-two beneficiaries is reduced by the section 642 (c) charitable distributions (as well as the tier-one distributions)...." *O'Bryan v. Commr*, 75 T.C. 304, at 309-310 (1980).

For example, suppose that a trust instrument provides that there must be annual distributions from income (and if income is insufficient, from corpus) of $50,000 to beneficiary "A" and $50,000 to Charity "Z", and that discretionary distributions may be made to beneficiary "C". Assume that the trust's total income that year was $62,000 of taxable interest and dividends, and that $50,000 distributions were made to each "A" and charity "Z", as well as $10,000 to "C". Under the two-tier system, "A" is a first-tier beneficiary and is taxed on the entire $50,000 that he or she was entitled to receive currently. "C' is deemed to receive $10,000 of tax-free corpus.

Suppose instead that there were no required distributions except for the $50,000 of income required to be distributed to Charity "Z", and that the trustee made discretionary distributions of $50,000 to "A" and $10,000 to "C". In that case, both "A" and "C" are tier-two beneficiaries. The trust can claim a $50,000 charitable income tax deduction, and the remaining $12,000 will be taxed to "A" and "C" in proportion to the distributions they received (five-sixths ($10,000) to "A" and one-sixth ($2,000) to "C").

For other examples with charitable distributions, see Alan S. Acker, *Income Taxation of Trusts and Estates*, 852-4th TAX MGMT. PORT. (BNA), Section V.F.6.b at A-114 & 115 (2014).

Applying this principle to trusts that will receive distributions over multiple years from a retirement plan account, the maximum tax savings from the charitable income tax deduction will occur if the trust is an "accumulation trust" rather than a "conduit trust." A conduit trust is a trust whose governing instrument contains instructions that retirement plan distributions received by the trust must be distributed currently to a beneficiary and must not be accumulated. See Treas. Reg. Sections 1.401(a)(9)-5, Q&A 7(a) (accumulation trust) and Q&A 7(c)(2) and (3), Example 2 (conduit trust). The primary beneficiary of a conduit trust is a tier-one beneficiary, whereas the beneficiaries of an accumulation trust will likely be tier-two beneficiaries. With respect only to the income that a conduit trust receives from a retirement plan account, none of it will qualify for a charitable income tax deduction since all of it must be distributed to (and taxed to) the tier-one beneficiary.

Of course, even conduit trusts can have income-based charitable bequests. If the trust has other sources of taxable income besides the IRD from a retirement plan, then the trust's tier-two beneficiaries could benefit from a charitable income tax deduction that offsets that income. The important point is that parties be alert to the tax outcome of whatever arrangement they choose.

Conclusion

With appropriate tax planning, a charitable bequest can be structured to provide significant income tax savings to a trust, estate, and its beneficiaries. One strategy is to use income-based charitable bequests by drafting the bequest in the income section of a will or trust instrument rather than as a bequest from corpus. This strategy can be particularly advantageous for a nontaxable estate. If the federal estate tax is repealed, then this planning strategy will take on even greater importance.

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EXHIBIT A

Assume that an individual with total wealth of $1,000,000 would like a charity to receive $50,000 and his child to receive everything else. The projected cumulative amount of taxable interest and dividends over the administration of his estate is $60,000. The estate and/or his child will pay tax on $60,000 of income with a traditional charitable bequest, but on only $10,000 of income with an income-based charitable bequest.

	Traditional Charitable Bequest	Income-based Charitable Bequest
Distributions:		
– Charity	$ 50,000	$ 50,000
– Child	1,010,000	1,010,000
–– Total	$ 1,060,000	$ 1,060,000
Income taxed to:		
– Charity	$ -0-	$ 50,000
– Child	$ 60,000	$ 10,000

ENDNOTES

1 IRS Chief Counsel Memorandum ILM 200848020 (July 28, 2008).

2 Treasury Regulations Section 1.642(c)(3)(b)(2) (2012).

3 Internal Revenue Code Section 170.

4 IRC Section 642(c)(1); Treas. Regs. Section 1.642(c)(1)(a)(1); Rev. Rul. 83-75, 1983-1 C.B. 114 (a charitable lead trust); and Private Letter Ruling 9044047 (Aug. 4, 1990).

5 The Tax Court explained the reasons for the tracing requirement in *Van Buren v. Commissioner*, 89 T.C. 1101, at 1108-09 (1987) .

6 See Rev. Rul. 2003-123, 2003-2 C.B. 1200 for the general proposition that a trust cannot claim a charitable income tax deduction for a charitable donation of trust principal as opposed to trust income.

7 IRC Sections 651(a) and 663(a); Rev. Rul. 2003-123, 2003-2 C.B. 1200.

8 IRS Chief Counsel Memorandum ILM 200848020 (July 28, 2008).

9 Treas. Regs. Section 1.642(c)(3)(a), which provides that IRD is income eligible for a charitable income tax deduction.

10 Treas. Regs. Section 1.642(c)(3)(b)(2) (2012).

11 Treas. Regs. Section 1.642(c)(3)(b)(2) - *Determination of the <u>character</u> of an amount deductible under section 642(c)*. (emphasis added). It was drafted primarily to counter tax instructions that were being used in some charitable lead trust documents. See Example One in Treas. Regs. Section 1.642(c)(3)(b)(2), where a charitable lead trust instructed ordinary income to be first distributed to the tax-exempt charity, thereby leaving greater amounts of tax-exempt interest for the trust. Since the clause had no economic effect, the charity and the trust were deemed to receive the same pro-rata share of ordinary income and tax-exempt interest.

12 Treas. Regs. Section 1.642(c)(3)(b)(2) (2012). See also the preamble to the 2012 final regulations which explained the purpose of the proposal: "If such provision does not have economic effect independent of income tax consequences, income distributed for a purpose specified in section 642(c) will consist of the same proportion of each class of the items of income as the total of each class bears to the total of all classes." *Background and Explanation of Provisions*, T.D. 9582, 2012-18 IRB 868, 77 F.R. 22483-22485.

13 IRC Section 1411(c)(5); Treas. Regs. Section 1.1411-8.

14 The instructions in the governing instrument, coupled with the physical separation of the IRD assets from other assets, should satisfy the Tax Court's standards for tracing the transfer to the charity as coming from the trust's income. See *Van Buren v. Commissioner*, 89 T.C. 1101, at 1108-09 (1987).

15 Treas. Regs. Section 1.642(c)(3)(b)(1) (2012).

16 See Treas. Regs. Section 1.642(c)(3)(b)(2), Example 2.

17 In the example in the text, the beneficiary who received the $30,000 distribution would only report $20,000 of taxable dividend income if all of the IRD had been attributed to the charity. By comparison, in the example where there was no economic effect, the beneficiary had $24,000 of taxable income: $12,000 of IRA income and only $12,000 of dividend income.

18 Choate, Natalie, *Life and Death Planning for Retirement Benefits*; 7th ed. (2011), paragraph 7.4.03.G

19 Treas. Regs. Section 1.661(a)-2(f)(1); *Kenan v. Commissioner*, 114 F.2d 217 (2d Cir. 1940). See also Gen. Couns. Mem. 39,388 (May 25, 1984) concluding that a trust must recognize gain when distributing appreciated stock in satisfaction of a direction in the trust instrument to pay net income to the beneficiary.

20 Rev. Rul. 83-75, 1983-1 C.B. 114, where a charitable lead trust's distribution of appreciated securities to a charity triggered income, but the trust was entitled to claim a fully offsetting charitable income tax deduction since the governing instrument required the distribution of income to charity. See also Private Letter Ruling 9044047 (Aug. 4, 1990), where the Service reached the same conclusion in a situation that involved two identical charitable lead trusts.

21 ILM 200644020 (Dec. 15, 2005). A trust's use of an IRA to satisfy a fixed dollar charitable bequest was deemed to trigger taxable income to the trust but the trust could not claim an offsetting charitable income tax deduction since there were no instructions in the governing instrument to leave income to charity.

22 Charitable bequests of savings bonds were analyzed in Rev. Rul. 80-118, 1980-1 C.B. 254 and Private Letter Ruling 9845026 (August 11, 1998). See also Treas. Regs. Section 1.691(a)-2(b), Ex. (3).

23 Private Letter Rulings 200002011 (Sept. 30, 1999) and 200012076 (Dec. 29, 1999) (employee stock options bequeathed to a charity by a will) .

24 See the IRS private letter rulings described at *infra* n. 32.

25 If the retirement plan is an IRC Section 401(a) qualified retirement plan, married participants will need a waiver from the spouse for the payments to be made to any beneficiary other than a surviving spouse. IRC Sections 401(a)(11)(B)(iii) and

417(a)(2)(A). IRAs usually do not require such a waiver.

26 Private Letter Rulings 200425027 (Feb 27, 2004) and 9826040 (March 30, 1998). By comparison, if the IRD consists of interest from savings bonds or an annuity contract the tax does apply. Rev. Rul. 80-118, 1980-1 C.B. 254 (savings bonds) and Private Letter Ruling 200425027 (Feb 27, 2004) (annuity contract).

27 Neither the donor's estate nor heirs will recognize taxable income if retirement plan / IRA proceeds are paid directly to a charity or to a charitable remainder trust. Private Letter Rulings 200826028 (Mar. 27, 2008), 200652028 (Sep 13, 2006), 200633009 (May 16, 2006), 200618023 (Jan 18, 2006), 9723038 (March 11, 1997) (public charity); Private Letter Rulings 9838028 and 9818009 (private foundation); Private Letter Rulings 9901023 (Oct. 8, 1998) and 9634019 (May 24, 1996) (charitable remainder trust).

28 Private Letter Rulings 200002011 (Sept. 30, 1999) and 200012076 (Dec. 29, 1999).

29 IRD is included in an estate's or trust's income and is eligible for an offsetting charitable income tax deduction. Treas. Regs. Section 1.642(c)(3)(a).

30 IRC Section 642(c); Treas. Regs. Section 1.642(c)(1).

31 This was the conclusion in PLR 201438014: "the terms of Trust do not direct or require that the trustee pay the pecuniary legacies from Trust's gross income. Accordingly, the transfer of a portion of the IRA in satisfaction of the pecuniary legacies does not entitle Trust to a deduction under section 642(c)(1)."

32 Private Letter Rulings 201444024 (March 24, 2014) (An ***IRA*** payable to a trust where *residue* was payable to a charity, could be retitled and then only charity would have income); 201330011 (March 5, 2013) (***IRA*** payable to estate with pour-over into a trust; two charities would each receive a fraction of *residue* of a trust; trustee had power to allocate trust property disproportionately); 201013033 (Nov 18, 2009) (***IRA*** payable to estate could be "transferred" to a trust, which could in turn transfer the IRA to various *residual* charities; trustee had power to allocate trust property disproportionately); 200633009 (May 16, 2006) (***IRAs*** where *residue* of estate to go to charity; executor had power to "make distributions ...either pro-rata or otherwise"); 200850004 (Sep. 8, 2008) (probate court specifies that ***IRAs*** payable to the estate should be the source of payment for the share of the estate allocable to charities); 200845029 (July 10, 2008) (***defined benefit plan*** payable to estate where *residue* of estate is payable to charities); 200826028 (Mar. 27, 2008)(*residue* of trust payable to charities and trust instrument permits in-kind distributions); 200652028 (Sep 13, 2006) (***IRAs*** where *residue* of estate was left to a charity); 200618023 (Jan 18, 2006) (***annuity contracts*** assigned to charitable residuary beneficiaries when *state law,* rather than the will, permitted non-pro rata distributions), 200617020 (Dec 8, 2005) (***IRA*** where *residue* of estate was left to a charity), 200511174 (Feb 8, 2005) (***IRAs & 401(k) plan*** where *residue* of estate was left to charity); PLR 200526010 (Mar. 22, 2005) (***IRAs*** payable to ***trust*** with charitable residue); 200452004 (Aug. 10, 2004) (***IRAs*** and ***deferred annuity contracts*** to charitable *residuary*) and

200234019 (May 13, 2002) (***IRAs*** and ***403(b) accounts*** where ***portion*** of the estate went to charity).

33 PLRs 200221011 (Feb. 12, 2002) and 200336030 (June 3, 2003) (**IRAs** and ***savings bonds***); PLR 200526010 (Mar. 22, 2005) (IRAs and ***savings bonds***); PLR 200537019 (May 25, 2005) (***annuity contracts***).