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Charitable Giving With Non-Charitable Trusts

Ideas to discuss with philanthropically inclined clients

Affluent families usually accumulate much of their wealth in trusts.¹ These trusts may include charitable trusts, namely either private foundations (PFs) structured as trusts or split-interest trusts (that is, charitable lead trusts and charitable remainder trusts). Typically, however, the vast majority of a family's wealth will be held in trusts that were designed primarily to benefit individual family members and their descendants. This poses an interesting challenge for philanthropically inclined clients and their advisors. In these instances, finding ways to tap into the family's non-charitable trusts for charitable giving becomes a compelling goal.

Competent clients typically can donate assets to charity from their fully revocable trusts, but what about from irrevocable trusts? There are two primary ways to engage in charitable giving using assets held in an irrevocable trust.

First, if permitted, the trust itself could donate to charity. Pursuant to the requirements of Internal Revenue Code Section 642(c) more fully described below, the trust can then take the charitable income tax deduction. Generally, federal income tax deductions taken at the trust level would be more beneficial than if taken at the individual level, because trusts reach the highest marginal tax bracket at much lower dollar levels than individuals.² (In 2021, the top marginal tax for trusts kicks in at only \$13,050 of income.)

Second, the trust could distribute cash or other assets to beneficiaries to then donate themselves. This could be desirable, for example, if the beneficiaries wish to increase their itemized deductions or if the irrevocable trust may be in a state without income taxes while the beneficiaries may be in high income tax rate states. Distributions to the beneficiaries generally will carry out distributable net income and thus be income reported by the beneficiaries on their individual returns. Donations to charity from such distributions can then be personally deducted by the beneficiary. If the trust distributes assets in kind to beneficiaries and such assets have substantial unrealized gain and are long-term capital assets, the beneficiary could take a deduction for the full fair market value of such assets.³

Giving Directly From a Trust

As referenced above, for a trust to take an income tax charitable deduction, the donation must meet the requirements of IRC Section 642, which provides that a trust is allowed such deductions for "any amount of the gross income, without limitation, which pursuant to the terms of the governing instrument is, during the taxable year, paid for a purpose specified in IRC Section 170(c) . . ."⁴ (emphasis added). The trust agreement must, therefore, specifically permit payments to charity. These payments can be cash to the extent of the lesser of taxable income for the year or the amount of contribution. The trust also can get a deduction for non-cash asset contributions that the trust purchases with income, but only as to the adjusted basis. If such assets were contributed to the trust, the trust can't then receive a charitable tax deduction for a donation of such assets to charity. Notably, however, unlike individuals, trusts can receive deductions for donations to foreign organizations operated

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exclusively for a charitable purpose.

Distribution directly to a charity that's a beneficiary of the trust. Are charitable organizations permissible current beneficiaries? For example, if the trust is a spray trust, does the trustee have flexibility to distribute not only to family members but also to one or more of the family's PFs, donor-advised funds (DAFs), or to charity in general? If so, then each year the trustee can determine whether it might be beneficial to donate all or a portion of the trust's income to charity. Even if charity is permitted as a current beneficiary, the trustee may want to confirm that the family member trust beneficiaries don't object to such charitable distributions.

Specific power to add charitable beneficiaries. Does the trust give a non-adverse party the power to add charitable beneficiaries? This power is often included in a trust to cause the trust to be a grantor trust for income tax purposes while not being subject to estate tax at the grantor's death. If a non-adverse party has this power, and the trust beneficiaries are in favor of adding charitable beneficiaries, this may be a relatively easy way to allow a trust to directly distribute to charities. For example, the non-adverse party could add the family's PF and/or DAFs as permissible beneficiaries, and then the trustee can make direct donations to the family's charitable giving entities whenever doing so is determined to be in the best interests of the non-charitable beneficiaries.

Trust protector powers to add beneficiaries. Is there a trust protector with authority to add or remove beneficiaries of the trust? Sometimes a trust may contain a provision that more generally permits a trust protector to add beneficiaries. If a trust protector (who may or may not be a fiduciary) has this power, then the trust protector can add charitable beneficiaries when it's determined to be in the overall best interests of the trust and consistent with the purposes of the trust. Because providing flexibility to use the trust funds to contribute to charity directly should maximize benefits to the family, ordinarily granting the trustee the power to distribute to charity should be in the beneficiaries' best interests. The actual decision to donate to charity in a particular year would then be exercised subject to the trustee's fiduciary duties of loyalty and impartiality to the other beneficiaries.

Lifetime powers of appointment (POAs). Does a primary beneficiary or other individual have a lifetime power to appoint trust assets to charity now? If so, then such beneficiary or other individual can exercise that power by instructing the trustee to make the distribution. For example, although a surviving spouse can't hold a lifetime power over a marital trust, the spouse may have a broad special lifetime power over a shelter trust and could determine that it's desirable to appoint some of the trust's income to charity.

If an independent trustee is authorized to distribute to a beneficiary pursuant to very broad standards, in many circumstances the trustee should be comfortable making distributions to facilitate the beneficiary's philanthropic giving.

Testamentary POAs. Does anyone have a testamentary power that could expand the beneficiaries to include charity following that power holder's death? In addition to, or instead of, lifetime POAs, a surviving spouse or other primary beneficiary (or other power holder) may be able to appoint trust assets for the benefit of charity at death. Although the gift would be postponed until the power holder's death, this can be another way to make charitable gifts out of the trust's assets.

Charities Aren't Beneficiaries

What are the options for distributing to charity when charitable organizations aren't current or potential trust beneficiaries? In some trusts, it might not be possible to distribute to charity directly from the trust, or it might be desirable for the charitable donations to be made at the beneficiary level. Here are some questions to consider.



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Non-ascertainable distribution standards.

Can the trustee distribute in its sole and absolute discretion or for a beneficiary's best interests? This is the most flexible distribution standard, but typically will be available only to an independent trustee (one who isn't a beneficiary or a related or subordinate party). If an independent trustee is authorized to distribute to a beneficiary pursuant to these types of very broad standards, in many circumstances the trustee should be comfortable making distributions to facilitate the beneficiary's philanthropic giving.

Ascertainable standards. Is the trustee limited to distributions pursuant to ascertainable standards like health, education, maintenance and support (HEMS)? If so, is the trustee (including any beneficiary who's acting as trustee) comfortable treating annual charitable giving as part of the beneficiary's support? Could one typically consider a beneficiary's ordinary charitable giving obligations

(for example, to church, synagogue, private school or memberships at important cultural institutions) to be part of that beneficiary's support in reasonable comfort and in the standard to which they're accustomed? If the trustee is comfortable that the distribution is in furtherance of maintaining the beneficiary's lifestyle, which includes charitable giving or related membership dues, then such distributions could be permitted. In some cases, such as paying tuition for religious school or expected donations to a private elementary school, the distributions might even be appropriately deemed to be for the beneficiary's education.

Trustee guidance. Does the trust instrument elaborate on whether the ascertainable standards for maintenance and support can include charitable giving? If not, is there a letter of wishes or other instruction or communication that may help illuminate settlor intent? There's increasing interest

in further exploring what such standards really mean and providing more guidance to trustees. In this regard, adding a charitable giving element may be helpful. But if keeping a HEMS standard is important to avoid estate tax inclusion for a beneficiary trustee, then the drafting for allowing such distributions or the administration of a trust with such distributions must be done carefully.

Additional Options for Trusts

Contribute trust assets to a limited liability company (LLC). Even if the trust doesn't permit distributions to charity, a trustee could consider investing trust assets into a new LLC. The manager of the LLC can then make donations to charity directly from the LLC. The charitable deductions would pass through to the LLC members, which would be 100% to the trust if it's the sole LLC member. As with many of the techniques described above, the trustee should

fully disclose this approach to the beneficiaries and confirm they don't object.

Decant or merge trust into a new trust. If there aren't satisfactory ways to distribute to charity with the current instrument, explore decanting or merger into a new trust with more flexible philanthropic provisions. While statutory decanting might not permit the addition of new beneficiaries, there are some other possible approaches. Such provisions could potentially include adding lifetime POAs that would include charity. Expanding POAs avoids the trustee taking the initiative to try to add beneficiaries to the trust. For example, in the Illinois Trust Code, a trustee can decant to modify a POA of a power holder to expand the class of permissible appointees.⁵ In addition, state decanting statutes might begin to have the insight to expressly permit the addition of the grantor trust power to add charitable beneficiaries.



Trust Design for New Trusts

In addition to creative thinking about old and cold irrevocable trusts, estate-planning professionals can advocate for designing estate plans that maximize future flexibility for charitable giving. There's a tremendous opportunity for advisors to be proactive in encouraging clients who are still in the process of designing (or re-designing) family trusts to incorporate provisions that preserve the opportunity for future philanthropy from such trusts.

Revocable trust powers. While competent settlors usually can make or direct charitable gifts from trust assets, revocable trusts should also give a successor trustee the ability to continue the settlor's annual charitable gifting programs or to make other charitable gifts that are consistent with the settlor's wishes during any times that the settlor may be incapacitated.

If a settlor has very specific charitable interests and goals, these can be expressed as philanthropic guidelines or even as mandates regarding future charitable giving.

Include charities as permissible beneficiaries. As a default in a spray trust (or non-marital and non-IRC Section 2503(c) single beneficiary trust), the trust can include particular charities such as the family's PF or DAF as a permissible beneficiary. Or the instrument could leave it open for the trustee to distribute to any charity as long as no beneficiary objects within a certain period after notice of the intended distribution.

Broad special POAs. Trusts should ideally grant the primary beneficiary of a trust special lifetime and testamentary powers that permit the holder to direct the trustee to make distributions to charity. This would be a non-fiduciary power and puts the charitable donation decision in the hands of the primary beneficiary each year and at death.

Disclaimer planning. Philanthropic disclaimer planning is often overlooked, but it can be a tax-efficient approach for putting philanthropic giving decisions in the hands of inheritors. A trust can be designed for charitable recipients following a disclaimer. This can involve the beneficiaries in planning for such disclaimers by seeking their input as to charities or types of charities that would receive distributions in the event of a disclaimer. Practitioners should also pay attention to tax apportionment provisions to make it clear that any disclaimed amount to qualified charities won't be liable for any estate taxes. And if the disclaimer passes to a family's PF, there should be planning to ensure that the disclaimant doesn't have control over the PF's use of the disclaimed amount as a director or officer of the PF. Ordinarily, the preferred approach is to have the disclaimer pass to a DAF established by or for the disclaiming beneficiary.

Ultimate contingent beneficiaries. Often the default so-called "atom bomb" beneficiaries are left as the settlor's heirs at law. Instead, especially for multigenerational trusts, clients may prefer to name a charity as the ultimate contingent beneficiary if the family line dies out. For example, the trust could specifically name the family's PF (if any), otherwise a family DAF (if any), otherwise to a charitable organization to be selected by the then-acting trustee after considering the types of organizations or values the settlor supported during life. If the settlor has created a letter of wishes to be kept with the trust records, such letter can incorporate information about the settlor's charitable values.

Designing trusts to encourage philanthropy. Clients can incorporate giving directions or suggestions into the instrument itself. Examples might include requiring that a certain percentage of income go to charity each year, like a tithing concept, or a settlor's expressions of philanthropic values and encouragement of giving back.

Special investment powers. The trust can expressly authorize fiduciaries to invest for impact, taking into account environmental, social or governance factors, or in other ways that promote the family's philanthropic values. However, such an authorization should be accompanied by adequate guidelines to protect the fiduciaries if those investments don't




perform as well as more traditional ones as some beneficiaries may challenge the reasonableness of the fiduciaries' investment decisions.

Expression of charitable interests. If a settlor has very specific charitable interests and goals, these can be expressed as philanthropic guidelines or even as mandates regarding future charitable giving. This type of expression could be included in the trust instrument, a letter of wishes or a Family Philanthropic Policy Statement that the settlor can create and modify over time.

Maintain Flexibility

With the continuing use of long-term trusts as preferred vehicles of wealth management and administration, especially with third and subsequent generations, it's important to consider the impact of such trusts on the ability of affluent families to be philanthropic.⁶ Estate-planning advisors can encourage clients to explore their charitable interests and determine if they want charitable access to their wealth in the future, and if so, how trust assets can be used for charitable giving.

It's helpful not only to recognize that many existing trusts may allow for charitable giving but also to consider drafting provisions that provide

the greatest flexibility. This is especially important as charitable giving methods continue to evolve. It would be unfortunate if new trusts don't provide such flexibility merely because the settlors were never made aware of such options. 

— *The authors thank Tony Oommen of Fidelity Charitable for suggesting this topic. It's one we haven't seen addressed or analyzed in this way before, and we're excited to share our thoughts and hopefully promote further considerations of ways that noncharitable trusts can be used for charitable giving.*

Endnotes

1. "In most families, 90% or more of the financial capital is held in trust by the third generation." James E. Hughes, Jr., Susan E. Massenzio and Keith Whitaker, *Complete Family Wealth*, Chapter 2, at p. 32 (John Wiley & Sons, 2018).
2. Treasury Regulations Section 1.642(c).
3. Treas. Regs. Sections 1.170A-1(c) and 1.170A-4.
4. See Internal Revenue Code Section 672(c)(1) (*emphasis added*). And IRC Section 170(a) is the general rule that permits income tax deductions for qualifying charitable contributions made within the taxable year.
5. See 760 ILCS 3/1211(d)(3) and (e).
6. For additional considerations, see Al W. King III, "Tips From the Pros: Charitable Giving With Non-Charitable Trusts" (June 2015), www.wealthmanagement.com/estate-planning/tips-pros-charitable-giving-non-charitable-trusts.