

**Introduction** As the new year starts, many donors think about the future. Completing an estate plan can ensure peace of mind by providing for family and establishing one's legacy. Donors often work with their professional advisors to understand their financial and legal preferences and explore charitable giving options through their estate plans. Many also reach out to their favorite charitable organizations for guidance during this process.

In this article series, we explore the various considerations that charitable giving plays in estate planning. The first installment provided an overview of the foundations of an estate plan, an outline of the estate administration process and an introduction to simple charitable giving options in estate plans. This installment discusses more complex charitable giving options in estate plans including testamentary charitable gift annuities, testamentary charitable trusts and using traditional retirement plan assets to fund charitable gifts. With this knowledge, professional advisors and gift planners will be better equipped to assist donors in making impactful legacy gifts.

### **Testamentary Charitable Gift Annuities**

Charitable gift annuity (CGA) is a contract between the nonprofit and the donor. To create a CGA, the donor transfers property to the nonprofit and the nonprofit promises to pay the annuity for one life or two lives. Sec. 514(c)(5). A CGA can be established by a donor during his or her lifetime or at death. CGAs that are created by a donor's estate are referred to as testamentary charitable gift annuities (TCGA). A TCGA is created by the donor by including specific language in his or her will, trust or by beneficiary designation and is usually funded with cash or a qualified retirement asset such as an IRA. After the donor's death, the estate administrator or trustee transfers the designated amount or asset to the nonprofit in exchange for the gift annuity.

Donors may have many reasons for wanting to establish TCGAs for their heirs. Some donors may have their own gift annuities that they are pleased with and would like to create the fixed income benefits with a child, grandchild, sibling or family friend through their estate. The donor may also have a specific economic benefit that he or she believes is appropriate for a child, a brother, a sister or other relative which a fixed payment stream can easily accomplish by providing a steady stream of support over the beneficiary's lifetime. The payments are also secure since the payments are backed by all the assets of the nonprofit. Most nonprofits maintain a large annuity reserve fund, which is required by some state insurance commissioners. However, the endowment and all the real property and other assets of the nonprofit also stand behind the promise to pay a gift annuity, making it a secure inheritance structure and legacy gift.

**Drafting Considerations** Donors considering a TCGA should work closely with their advisors and the nonprofit's gift planner when setting up a TCGA in their estate plan. The language in the estate plan should specifically identify the annuitant or annuitants, the amount of the funding, the payment frequency and whether payments will be immediate or deferred. Depending on the donor's intent, the language may also provide instructions on the source of the annuity's funding such as cash, securities or a qualified retirement asset such as an IRA. If a qualified retirement asset is the funding source, the account owner must update the beneficiary designation to reflect the creation of a TCGA.

Because the TCGA is not established until after the donor's death, there are variables that require careful drafting or consideration. The donor may want to select a specific beneficiary age to commence payouts. For example, the drafting language may state that the annuity should not start payments until the beneficiary reaches age 65. If the donor lives to a senior age and the beneficiary has reached the designated age for payout by the demise of the donor, then an immediate or current gift annuity will be funded by the estate. If the beneficiary has not reached the required age, the annuity would be drafted as a deferred gift annuity. It is also important to remember that, if a minimum age does not align with the nonprofit's CGA policies, the nonprofit could decline to enter into a TCGA for very young annuitants. It is preferred to create a separate TCGA for each intended beneficiary.

Another variable requiring careful drafting is defining when the start date is for the TCGA. If the language sets up an immediate CGA, the start date is the date of the donor's death. In this situation, if funding is not received for a long period after the donor's death, the nonprofit could have to disburse makeup payments to the beneficiary. Thus, it is helpful to include language that defers the first payment for the TCGA; the deferral could be for one year after the donor's death or extended to a plausible date after the nonprofit will have received the funding contribution from the estate.

Due to potential changes in circumstances of the annuitants and nonprofits, there are other drafting considerations that should be discussed with the donor. These considerations include what happens if the annuitant does not survive the donor, if the nonprofit is no longer in existence at the time of the donor's death or if the nonprofit cannot issue the TCGA for any reason. The language should either provide for contingent plans in these instances or permit the estate administrator or trustee discretion in planning if such situations occur.

**Taxation** The donor will not obtain an income tax charitable deduction when creating a TCGA because the gift remains revocable. In addition, at the donor's death, the amount used to fund the TCGA is usually included as part of the donor's taxable estate at death. The inclusion of this amount in the donor's estate will likely have no impact since most donors do not have a taxable estate, considering the \$15 million estate and gift tax exemption in 2026. The present value of the annuity interest is a taxable estate gift to the annuitant, but the estate's \$15 million exemption will usually be sufficient to cover the gift. The donor's estate will be entitled, however, to an estate tax charitable deduction for the value of the charitable portion of the TCGA.

**Example 1** Molly was in her 80s and enjoyed the benefits of a gift annuity. She received high fixed payments and a substantial charitable income tax deduction. In addition, a portion of her payment was tax-free return from the principal. Molly was pleased with her gift annuity and decided to create a gift annuity for her daughter Tracy, 65, in her estate plan. Molly directed her attorney to include language in her Trust allocating \$100,000 from the residue of her estate to her favorite nonprofit for the purpose of funding a charitable gift annuity for Tracy beginning one year after Molly's death. Molly also asks the attorney to include a provision that, if Tracy does not survive Molly, then the \$100,000 should be given as an unrestricted charitable bequest to the nonprofit.

The gift planner at Molly's favorite nonprofit explains that, if Tracy is age 66 when the annuity commences, the \$100,000 gift annuity will pay 5.8% to Tracy for her lifetime. While the \$100,000 is included in Molly's estate, there is a charitable estate deduction of almost \$29,000, resulting in a taxable transfer of over \$71,000. With the \$5,800 annuity, \$3,729.40 of the payout will be tax-free and \$2,070.60 will be ordinary income. If Tracy lives longer than her estimated life expectancy, subsequent payments will be ordinary income. Molly is excited to update her Trust to provide lifetime benefits to Tracy while supporting her favorite nonprofit.

### **Testamentary Charitable Remainder Trusts**

A testamentary charitable remainder trust (TCRT) is a trust funded with assets from a donor's estate at death. A TCRT can be structured to make payments for the noncharitable beneficiaries' lifetimes, a term of years or a combination of lives plus a term of years. Although TCRTs can be structured as an annuity trust (TCRAT) or a unitrust (TCRUT), this article will focus primarily on TCRUTs. Once a TCRUT is funded, the beneficiaries receive a fixed percentage of the trust's value, between 5% to 50% each year. When the trust terminates, the trustee distributes the remaining assets to one or more qualified nonprofits. As with TCGAs, there is no income tax deduction allowed during the donor's lifetime because the trust is testamentary and could be revoked or modified prior to the donor's death. However, the present value of the charitable remainder qualifies for an estate tax charitable deduction which can reduce or eliminate any estate tax due.

A TCRUT can be an excellent option if a charitable organization is reluctant to issue a TCGA, particularly in cases where the donor has younger beneficiaries. If it seems likely that beneficiaries will be relatively young when a donor dies, a TCRUT for a term of years can be well-suited to provide extra support. This support can help them as they establish their careers, finish making student loan payments or reach their own retirement.

There are many benefits to a TCRUT. An additional advantage of a TCRUT in comparison to a TCGA is that the TCRUT can allow for more than two income beneficiaries. Furthermore, at termination, the corpus can be divided among multiple nonprofits. The variable payments of a TCRUT fluctuate with performance of the trust's investments and offer better potential protection against inflation. A TCRUT is also the preferred planned giving vehicle for larger contribution amounts. Thus, for high-net worth donors looking to establish a gift for multiple beneficiaries with a large funding amount, a TCRUT is an excellent option.

### **IRA to Testamentary Unitrust or Testamentary Gift Annuity**

Prior to 2020, non-spouse beneficiaries could spread out inherited tax-deferred retirement plans over life expectancy. By "stretching" the traditional retirement account payout, a beneficiary could reduce his or her income tax and benefit from tax-free growth for many years. The SECURE Act passed in 2019, however, eliminated the stretch provisions for inherited retirement accounts for most non-spouse beneficiaries. Thus, many beneficiaries must now receive distributions over a maximum ten-year period. As a result of this change in the law, one option that has become popular with IRA owners is to transfer their IRA at death to a TCRUT or TCGA to mimic the "stretch" benefits.

## "Give It Twice" Trust

A "Give It Twice" trust is a TCRUT commonly funded with a traditional IRA or other taxable retirement plan. As part of this plan, the IRA is transferred at death to a unitrust. The IRA is includable in the estate as an asset of the IRA owner under Secs. 2031 and 2033. Thus, 100% of the value of the IRA upon date of death will be reported on the IRA owner's estate tax return. However, since the unitrust is tax exempt, no income tax is paid when the IRA is distributed to the trust.

The full value of the IRA is reinvested within the TCRUT and provides income to children or other heirs, usually for a term of years. Over the life of the trust, the trust distributes income to the beneficiaries that is approximately equal to the initial funding by the IRA. At the end of the term, the trust remainder is distributed to nonprofits designated by the donor.

**Drafting Options** There are three primary methods to prepare the TCRUT document. The options are a lifetime charitable remainder unitrust which allows for the addition of the IRA proceeds upon the death of the IRA owner, an unfunded unitrust or a revocable trust or will with the required language.

One of the favorable benefits of charitable remainder unitrusts is that an addition can be made during life or at death. In order to do so, there must be a provision in the trust instrument that allows contributions from an estate and requires the contribution to be effective as of the date of death, even though payments may not be made until after full trust funding. For example, a parent with children could create a trust for one-life plus a term of years. The parent may receive unitrust income distributions during life and, upon death, their IRA proceeds are added to the unitrust which makes payments to the children for the term of years.

Some individuals desire to create a plan for the transfer of an IRA to a TCRUT, but do not want to fund and administer the trust during life. For the individual who does not wish to operate the trust during life but would prefer that the TCRUT is available to receive the distribution from an IRA, an unfunded TCRUT may be created. An unfunded unitrust may be a two-life unitrust or could be a one- or two-life plus term of years trust. The trust should be created prior to signing the beneficiary designation form and filing it with the IRA custodian. For a surviving spouse, the one life plus term of years unfunded unitrust is frequently selected. If using this method, it is always important to check with applicable state law to ensure it is permissible to create an unfunded trust.

The final option for documentation is to include a trust document within a revocable trust or a will. It should be clearly identified within the revocable trust or will as a separate charitable remainder unitrust effective only at the death of the testator or trust grantor. For clarity of intent, it is helpful if it has a specific number or Article designation. After the revocable trust or will has been signed, the grantor can then designate the TCRUT as the beneficiary of the IRA.

**Example 2** Sam and Marissa raised four children. Sam passed away last year, and Marissa used a spousal rollover to move Sam's IRA into her own IRA. Marissa now has an estate of \$1.6 million consisting of \$800,000 in her IRA and the balance in her home, CDs and mutual

funds. Marissa meets with her estate planning attorney to create a plan that benefits her four children and the three nonprofits that she regularly supports.

After several meetings with her attorney, Marissa signs an unfunded unitrust for her lifetime and then her four children for a term of 20 years. She changes the beneficiary designation of the IRA to the trustee of the unitrust. When Marissa passes away, the \$800,000 IRA is transferred to the 5% payout unitrust, saving all of the income tax on the IRA. It is invested for a term of 20 years and pays taxable income of \$800,000 to the children during that time. After 20 years, approximately \$1 million will be distributed in equal shares to Marissa's three favorite nonprofits.

Each of the four children will receive \$200,000 from the balance of the estate. Over a period of 20 years, each child will also receive \$200,000 of income from the TCRUT. Marissa especially likes the way the plan is balanced. Each child receives principal when she passes away and then income for a term of years. Marissa believes that this is a desirable plan for the children and an approximate future gift of \$1 million from the trust remainder will help her favorite nonprofits.

### **IRA to TCRUT Beneficiary Designation**

To designate a TCRUT as the beneficiary of a retirement plan, the plan owner should use precise language to ensure the funds are transferred correctly to the trust. For example, a person could create a trust for himself and his spouse and then update the beneficiary designation section of the retirement plan with the following sentence, "To ABC Bank as trustee of the charitable remainder trust dated July 4, 2026, for the initial benefit of Mr. and Mrs. IRA owner." If the TCRUT is created by a will or trust, the language may state the following, "To ABC Bank as trustee of the charitable remainder trust for [Name of Heir], identified as 'Article [X]' in Mr. and Mrs. IRA owner's Trust dated July 4, 2026."

### **TCGA Option**

There are many reasons why an IRA owner may prefer to fund a TCGA. First, if the beneficiary is fairly senior, the gift annuity will distribute a high fixed payout rate. Second, with the market fluctuations during the past several years, it may be more favorable to lock in a fixed payout, rather than a payout that may change with market valuations. Third, the cost of administration for a gift annuity is usually much less than the trustee cost for a charitable remainder trust. Fourth, a gift annuity may be funded with a smaller amount, since it is easier and less expensive to administer.

In PLR 200230018, the Internal Revenue Service (IRS) ruled favorably on the IRA owner's request to fund a testamentary charitable gift annuity. In particular, the IRS found that the plan would not affect the nonprofit's exemption status and would not cause the nonprofit to have unrelated business income (UBI) upon receipt of the IRA. In addition, the IRS ruled that the IRA is included in the IRA owner's estate but will not be taxed on the ordinary income from the IRA. The estate will also receive a partial estate tax deduction for funding the TCGA. While the ruling did not directly consider the taxation of payments to the annuitant, since the IRA is a pre-tax

ordinary income asset, the payments should be treated as ordinary income to the annuitant. Although private letter rulings are not a precedent, the key ruling that the IRA will not incur income tax for the estate or the nonprofit makes this an attractive planning option for donors.

If language for an IRA to a testamentary gift annuity is included in a beneficiary designation, it is suggested that the IRA owner send a copy of that IRA beneficiary designation to the nonprofit. This notice should include the name and address of the IRA owner and the name, address, birth date and Social Security number of the future annuitant. Giving notice enables the nonprofit to determine that the annuitant is qualified under its minimum age guidelines for the requested annuity. When the IRA owner passes away, the nonprofit will then be better prepared to issue the gift annuity for the selected recipient. The beneficiary should expect an extended delay from the date of death until the funding of the TCGA with this funding asset.

### Conclusion

Donors have many options available when making gifts from their estates, each offering different levels of flexibility. By understanding the foundations of an estate plan and planned giving options, professional advisors and gift planners can guide individuals in aligning their estate plan objectives with their charitable giving efforts.



#### ABOUT JAMES E. CONNELL

James E. Connell FAHP, CSA of Connell & Associates, Pinehurst, North Carolina, is a respected gift planning consultation firm with over four decades of experience offering a broad range of charitable estate and gift planning services to non-profits throughout the country. He heads CONNELL & ASSOCIATES, Charitable Estate & Gift Planning Specialists in Pinehurst, North Carolina. Contact him to help your organization analyze the value CGAs may provide.

Contact James at 910-295-6800 or [james@connellandassoc.com](mailto:james@connellandassoc.com) or fax him at 910-295-6866