

Pass Your Values, Not Taxes

How Philanthropy Can Play a Role in Your Estate Plans

By Benjamin Pierce

Aside from its valuable benefit to charities, philanthropy in estate planning is an excellent way for individuals to mitigate taxes for heirs while building a charitable legacy. To achieve the most desirable result—charitable impact and tax relief for heirs—consider the types of assets you plan to bequeath.

The Right Asset to Gift

A charitable gift at death, or a bequest, is a way to reduce the value of the estate and minimize taxes; a bequest is generally 100-percent tax deductible for estate-tax purposes. However, the tax benefits will vary depending on which types of assets are gifted to charity and which are left for heirs in the estate.

The most common way to give to charity in an estate is with cash or securities—but that is not always the most effective way. Individuals often opt to donate these types of assets because they assume it is easier to give a lump-sum donation and reduce the estate by the full market value of the gift. Then, the estate can allocate all remaining assets, including tax-deferred accounts, to family members. For example, a will might direct the estate to give \$100,000 to an alma mater and “leave the rest for my kids.”

While certainly favorable for charity, the choice to donate cash or securities and pass the tax-deferred assets to heirs can be cumbersome and costly, due to high estate and income taxes. Let’s look at an example.

An individual named Jim is fortunate to be in a situation where his non-retirement assets are sufficient to cover his daily expenses, and he only needs to absorb the minimum required distribution from his traditional individual retirement account (IRA) each

TABLE 1: VALUE AFTER TAXES OF CASH GIFTED TO CHARITY AND IRA BEQUEATHED TO HEIRS

	Traditional IRA to Heirs	Cash and Securities to Charity
a. Amount of bequest/gift	\$1,000,000	\$1,000,000
b. Federal estate tax due (@ 40%)	\$400,000	0
c. Amount remaining after estate tax is paid (a – b)	\$600,000	0
d. Federal income tax due (c x 39.6%)	\$237,600	0
Net remaining (c – d)	\$362,400	\$1,000,000

TABLE 2: VALUE AFTER TAXES OF IRA GIFTED TO CHARITY AND CASH BEQUEATHED TO HEIRS

	Cash and Securities to Heirs	Traditional IRA to Charity
a. Amount of bequest/gift	\$1,000,000	\$1,000,000
b. Federal estate tax due (@ 40%)	\$400,000	0
c. Amount remaining after estate tax is paid (a – b)	\$600,000	0
d. Federal income tax due (c x 39.6%)	n/a	0
Net remaining (c – d)	\$600,000	\$1,000,000

year. He plans to make a final gift from his estate to his favorite charity and leave everything else, including his overfunded IRA, to his heirs (see table 1). Jim, whose estate is large enough to be subject to federal estate tax, fails to realize the large remaining balance in his IRA will force his beneficiaries to pay significant estate taxes (up to 40 percent of the remaining taxable balance) and then income taxes every time they receive distributions from the account (subject to certain deductions). In the end, the value of the assets left to heirs is significantly diminished (Hammer and Shin 2013).

In estate planning, the more strategic option leverages a charitable gift to benefit both nonprofits and heirs by naming a charity as beneficiary to the tax-deferred assets.

Let’s take a second look at Jim. If Jim opts instead to name the charity as beneficiary to his IRA, and leaves the cash for his heirs, he saves his heirs

from paying estate tax on the retirement account and income tax every time funds are distributed (see table 2). Bonus: The nonprofit organization receives the full amount of the IRA, free from income and estate tax.

While these examples are simplified and do not account for certain deductions, they highlight the implications of bequeathing one type of asset over another to heirs. Jim’s heirs could receive \$237,600 more from the cash bequest than the traditional IRA bequest.

No matter which asset is gifted, the charitable beneficiary receives the full value of the gift, which allows Jim to base his decision about which asset to gift on what’s best for the entire estate—not just one party.

Additional Considerations

While Jim’s story focuses on which type of asset to gift, he also needs to consider the documentation, asset value, and



beneficiary organizations of a planned gift from his estate.

The decision of how much to give is very personal and one that should be made with the assistance of trusted advisors. No matter the intended gift amount, remember that the value of assets will shift over time. Estate plans should be reviewed every three to five years to account for changes in family structures, such as a marriage or birth, shifts in tax and estate law, and fluctuation with investments. If the goal is to make a very specific gift to charity, yet assets have decreased in value since the plans were first established, the intended gift amount may need to be adjusted, or the estate will need to make up the difference elsewhere.

An estate plan also needs to include the name of the beneficiary, or the organization that will receive the donation. Individuals most often choose to give directly, through a private foundation, or with a donor-advised fund—each of which offers different benefits.


In the example above, Jim names a donor-advised fund as charitable beneficiary to his assets because his goal is to keep heirs involved in philanthropy

and on a path to mirror his generous legacy. A donor-advised fund allows for an “alternative inheritance,” or passing of values, and helps foster a deep, long-standing connection with heirs.

Keep in mind that any plan to name beneficiaries—whether of charitable or unrestricted assets—will not happen on its own. Estate plans must be crafted throughout a lifetime and documented, ideally with the aid of a professional.

When building philanthropy into estate plans, make it a priority to establish and communicate last wishes by doing the following:

- Create a charitable giving plan.
- Confirm that assets are in a position to meet your current objectives.
- Hold family meetings to prepare heirs.
- Send charities a letter of intent.

Philanthropy may be a beneficial addition to your estate plans, but it should be approached strategically. Work with an advisor, and make sure the choice to bequeath assets to nonprofit organizations aligns with your overall financial plans and long-term goals. 

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References

Hammer, S. and A. Shin. 2013. The Joy of Charitable Giving: Strategies and Opportunities. Research. Vanguard Investment Strategy Group. Malvern, PA, 2013: 3–5.

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