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The Quest for the Right Bequest

By RACHEL EMMA SILVERMAN OCTOBER 1, 2011

Many people want to use part of their estate to help charities they believe in—leaving a legacy of helping out the less fortunate, nurturing the arts or supporting other important causes.

But with estate-tax rules changing almost every year, and with President Barack Obama proposing to limit the value of charitable deductions for high-income earners, planning for charitable gifts has rarely been more confusing.

There are numerous ways to leave money for charity while still getting significant tax breaks, and in some cases generating income for you or your family while you are alive. One of the simplest—and often most overlooked—ways to make sure your charitable legacy lives on after you are gone is a "bequest," a gift to charity at your death, typically made through your will.

Cutting Estate Taxes

Making a bequest reduces the size of your estate, effectively leaving less money subject to estate taxes. Another advantage: You can change the provisions in your will, including how much to donate and to whom, anytime before your death. But because a bequest becomes effective after death, donors can't enjoy an income-tax deduction for the gift.

Giving to charity during one's lifetime, by contrast, can generate income-tax deductions—but the gifts are irrevocable. Many donors make substantial gifts during their lifetime as well as support their favorite charities in their wills.

Jon Krause

This year and in 2012, people can shield up to $5 million—$10 million for married couples—from federal estate tax. In 2013, the exemption will go back down to $1 million, unless Congress votes to raise it.

Still, most people leave money to charity for reasons beyond tax savings. In 2010, when the federal estate tax disappeared for a year, charitable bequests nevertheless rose over 2009 by an estimated 16.9%, adjusted for inflation, to $22.83 billion, according to the Giving USA Foundation.

Bequests are still relatively uncommon. One study analyzed 20,000 Americans over the age of 50 from 1995 to 2006, and found that fewer than 9.5% of those who donated more than $500 a year planned to make a bequest, according to Russell N. James III, an associate professor in the division of personal financial planning at Texas Tech University, who conducted the study. People without children or grandchildren were far more likely to leave bequests to charity, Mr. James found.

One particularly tax-efficient way to make a bequest is to donate part or all of your regular individual retirement account to charity by designating a charity as a beneficiary. Bequeathing an IRA to charity can save your heirs income taxes that they otherwise might owe on an IRA's required minimum distributions, as well as reducing the size of your estate. (Rules governing IRAs, which aren't passed on through wills, are thorny, so be sure to seek tax counsel before bequeathing such an account.)

Estate Tax Calculator

When making a bequest, donors can attach strings, such as asking the charity to use the money to fund a certain project. For instance, Joan Kroc, the wife of McDonald's founder Ray Kroc, left some $1.5 billion to the Salvation Army upon her death in 2003. She specified that her gift was to be used for the development of community centers.

It's best for donors to discuss plans with the charity in advance, so it can be prepared for the money and make plans for how best to use it, say advisers. That is especially important if you plan to leave tangible objects, such as artwork to a museum; make sure the charity actually can accept the object before leaving it. Also, talking to the charity in advance about any restrictions to the donation can help prevent misunderstandings going forward.

It also is smart to talk with family members if you plan to make a bequest, so they understand why the money is going to the charity and not to them.

Generating Income

Some charitable vehicles, such as "charitable remainder trusts" and "charitable gift annuities," allow you to support a charity after your death while generating an income stream—and even income-tax deductions—during your lifetime. These tactics are particularly smart for donors worried about maintaining cash flow after making a gift.

In charitable remainder trusts, donors transfer assets to an irrevocable trust, which then pays the donor or his family income for a set period of time, or until the donor dies. At the end of the trust's term, whatever money is left goes to a charity designated by the donor. The donor receives an upfront tax deduction for the money expected to be received by the charity, while the income stream that donors receive is taxable.

Charitable gift annuities are similar, but are typically simpler. Donors can set them up directly with a charity, usually avoiding the legal fees necessary to create a trust. The charity promises to pay the donor a fixed amount regularly for life. Although a portion of the annuity payments is taxable, donors also receive an upfront income-tax deduction for the amount estimated to end up with the charity upon death.

—Rachel Emma Silverman is the author of "The Wall Street Journal Complete Estate Planning Guidebook" (Crown Business).