Planning for Beneficiary Designations

Clients may have charitable and non-charitable beneficiary designations in place for a wide variety of assets and accounts. It’s vital that these designations be coordinated with the client’s will, living trust and joint ownership arrangements and reviewed on a regular basis. Among the beneficiary designation tools:

- Payable on death accounts – Clients can name beneficiaries, including charities, for bank accounts. During the account owner’s life, he or she retains all rights to the funds and can make any changes. Only at the account owner’s death does the POD beneficiary have the right to what remains in the account.

- Transfer on death accounts for stock, bonds and brokerage accounts – Named beneficiaries will inherit accounts automatically, without the need for probate. Designations are revocable and give the beneficiary no rights during the account owner’s lifetime. Charity can be named as a TOD beneficiary.

- Beneficiary deeds for real estate – Effective January 1, 2016, owners of California real property can sign and file revocable transfer on death deeds naming beneficiaries, including charities. These deeds do not give the named beneficiary any rights in the

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property prior to the owner’s death. [Note: At the owner’s death, Berkeley would have to perform due diligence to see if it can accept the property.]

• Transfer on death designations for vehicles – Vehicles registered with a TOD designation pass outside probate.

In addition to these beneficiary designations, clients may have named beneficiaries for life insurance, IRAs, 401(k)s and 403(b)s.

Other considerations when drafting estate documents and reviewing beneficiary designations:

• Under federal law, a surviving spouse is automatically entitled to assets in a 401(k) account unless a waiver has been signed. This does not apply to IRAs.

• A surviving spouse has a right to half of a couple’s community property in California. This is in addition to bequests left in a will or living trust, unless the document provides otherwise.

• Beneficiary designations on retirement accounts and life insurance policies generally supersede contrary testamentary dispositions in wills or living trusts.

• It’s not possible, under Treasury regulations, to designate a charitable beneficiary of U.S. savings bonds. However, bonds can be left to charity in a will or through a revocable living trust, avoiding all income tax that an individual beneficiary would owe on the income in respect of a decedent.

UC Berkeley Planning Pointer:

**Revocable Living Trusts: Another Source for Charitable Giving**

Revocable living trusts have a number of planning advantages, but they also offer ways to make gifts to charity.

**Lifetime gifts** – The grantor can name charity an income beneficiary of a living trust. For example, the trust can provide that a percentage of the income be paid to charity annually, with the income tax deduction passing through to the donor.

**Distributions at death** – The grantor can direct that, at death, the trustee distribute certain assets or a percentage of the trust corpus to charity. A charitable deduction is available for the value of charity’s interest, just as it would be with a bequest in a will. Assets generally pass to charity faster through a trust than a will. Privacy also may be a consideration.

**Revocable charitable remainder trust** – Donors can create revocable inter vivos trusts that provide them with income for life with remainder to charity. The donor receives no income tax benefit from the trust, but is able to exercise unlimited control over the trust, which is not possible with a qualified charitable remainder trust.

Upon the donor’s death, if the trust has not been revoked, trust assets will be included in the donor’s gross estate but will “wash out” as an estate tax charitable deduction [Code §2055].

**Conversion into a qualified charitable remainder trust** – Clients can provide that their revocable living trusts be transformed at death into qualified charitable remainder trusts, providing lifetime income to a family member plus a substantial estate tax charitable deduction.

**Conversion into irrevocable, nonqualified charitable remainder trust** – A revocable trust can become irrevocable at death, paying income to family members, with remainder to charity. Such a trust makes sense where the client wants more flexibility for family beneficiaries (to invade trust principal, for example), and has no need for an estate tax charitable deduction.

**Conversion to a QTIP trust, remainder to charity** – A revocable living trust can become an irrevocable QTIP trust at death of the first spouse, securing the unlimited estate tax marital deduction [Code §2056(b)]. A subsequent unlimited estate tax charitable deduction will follow upon the death of the surviving spouse – with charity as remainderman. A qualified charitable remainder trust is unnecessary where estate taxes are not a problem at the death of the first spouse [Code §§2044(c), 2055].
• If the will directs that estate administration expenses and taxes are to be paid from the probate estate, an individual receiving probate assets may pay taxes and costs on assets passing via beneficiary designations. If probate assets are left to charity, the amount intended for charity may be reduced, in turn lowering the estate tax charitable deduction.
• Clients should weigh the tax implications of naming individuals as beneficiaries of IRAs and other retirement accounts because of the federal and state income tax liability, as well as potential estate tax liability. Amounts passing from retirement accounts to charity avoid both income and estate taxes.

**Spouse Gets No Choice Over Charitable Bequests**

Michael McShane left his mutual funds, checking accounts, stocks, bonds and cash to his wife, Gwendolyn, in his will. He left mutual funds, “up to $800,000,” to his first wife, pursuant to a divorce agreement. McShane also left “up to” $250,000 from mutual funds, stocks, bonds and cash to the University of Wisconsin School of Business, $150,000 to the University of Colorado School of Business, $50,000 each to two other charities and $25,000 and $20,000, respectively, to two cousins. He left the residuary estate to his wife, who was also the estate’s executor.

Gwendolyn claimed that McShane’s intentions were ambiguous because of the use of the “up to” amounts to the named charities and individuals. She argued that the mutual fund proceeds should be distributed to his first wife and the cousins in the amounts stated, with nothing going to the charities, saying the language was precatory. Although the value of McShane’s estate was about $8 million, Gwendolyn expressed concern that she might not have enough money to survive if the charitable amounts were paid. The charities objected, saying they would not have been named in the will if McShane had not intended them to receive the bequests.

The Los Angeles County Probate Court found that the “up to” language was not precatory and nothing gave Gwendolyn discretion over what the charities would receive. The “up to” language recognized that mutual fund values may go down and there might not be enough to pay everyone. The bequests were contingent on the securities having the necessary value.

In an unpublished opinion, the California Court of Appeals, Second District, agreed, noting that under Gwendolyn’s reading of the will, the charitable provisions would be inoperative, violating state law requiring all words of an instrument to be given some effect and state policy favoring construction of a will to uphold charitable bequests (*Estate of McShane v. University of Wisconsin School of Business*, B261360).
Donor List Need Not Be disclosed

Americans for Prosperity Foundation (AFP), a 501(c)(3) organization, sought to permanently enjoin the attorney general of California from requiring Schedule B of IRS Form 990 in order to register in the state. Schedule B includes the names and addresses of donors giving more than $5,000 during the year. Form 990 is available to the public, but Schedule B is not [Code §§6104(b), (d)(3)(A)]. From 2001 to 2010, AFP filed and the attorney general accepted Form 990 without Schedule B. In 2013, AFP was notified that its filing was incomplete because it did not include an unredacted Schedule B.

In February 2015, the U.S. District Court (CD CA) granted a preliminary injunction, finding that AFP had “raised serious questions” The attorney general appealed. The Ninth Circuit held that the District Court is bound by the Ninth Circuit’s ruling in Center for Competitive Politics v. Harris [784 F.3d 1307] that the Schedule B requirement was not facially unconstitutional, but instructed the District Court to have a trial on AFP’s “as-applied” challenge.

At trial, the attorney general cited a “compelling interest in enforcing the law and protecting the public,” adding that there was no actual burden on First Amendment rights. Having the information from Schedule B allows the attorney general “to determine whether an organization has violated the law, including laws against self-dealing, improper loans, interested persons, or illegal or unfair business practices.” The court found, however, that the attorney general was “hard pressed” to pinpoint a single witness to corroborate the necessity of the Schedule B in conjunction with the office’s investigations. Even if the office could, the court found the disclosure demand “more burdensome than necessary.”

Trial testimony indicated that the attorney general’s office does not review Schedule Bs upon collection and that they are seldom used in investigating charities, noting only five instances of use in approximately 540 investigations over the prior decade. Relevant information can be obtained from other sources, according to the testimony.

The court said that while the Ninth Circuit “foreclosed any facial challenge to the Schedule B requirement,” it left open the possibility that a charity could show “a reasonable probability” that the compelled disclosure of names will subject the organization’s donors to threats, harassment or reprisal that would warrant relief on an “as-applied” challenge. The court said it was “more than satisfied” that such a showing was made, with evidence presented that AFP employees, supporters and donors faced public threats, harassment, intimidation and retaliation once their support became publicly known.

Although the attorney general claimed that Schedule B was not available for public viewing, the court found the office “has systematically failed to maintain the confidentiality of Schedule B forms,” with staff members testifying that in separating confidential information from public filings “there is room for errors to be made.” In fact, AFP pointed to more than 1,400 Schedule Bs posted for viewing on the attorney general’s public website. The court found this disclosure “irreconcilable” with the assurance of confidentiality. AFP has “suffered irreparable harm,” said the court, noting that the attorney general’s threat to cancel the organization’s charitable registration would “preclude it from exercising its First Amendment right to solicit funds in California.” The court found that the disclosure requirement burden on First Amendment rights outweighs any “negligible burden” of an injunction on the attorney general. Accordingly, the court permanently enjoined the attorney general from requiring AFP to file Schedule B to their Form 990. (Americans for Prosperity Foundation v. Harris, Case No. CV 14-9448-R).