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- Giving Techniques: Goals Affect Combinations
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CHARITABLE GIVING

a resource for charitable gift planning professional advisors

The Art and Science of Blended Gifts

History is filled with countless examples of creative individuals, from alchemists to scientists to software designers, who combined known items or concepts to create novel results—sometimes even historic inventions.

- In 19th century England, William Henry Perkin, a teenaged chemistry student, blended coal tar and tree bark in an attempt to develop artificial quinine to treat malaria.[1] While his idea failed as a treatment, he discovered he had produced the world's first synthetic dye—an industry that's worth trillions today.
- Alfred Nobel, a Swedish engineer, found that blending nitroglycerin with a kind of diatomaceous earth kept the nitroglycerin stable.[2] Many credit the resulting invention—dynamite—with changing the course of history.
- In the mid-20th century, a Swiss engineer named George de Mestral was inspired by the strong grip of burrs imbedded in his dog's fur. He combined strips of velvet and a crocheted weave to create VELCRO®. Today, Velcro Industries produces thousands of products ranging from zipper-like closures to fasteners for NASA spacesuits.[3]

Planners have been helping donors blend gifts for years, yet many remain unaware of the power that can result from combining gift strategies. This issue of ***Charitable Giving*** looks at blended gifts—what they are, how gift categories are combined, and the potential impact blended gifts can have on donors and charitable organizations.

Blended Gifts: The How and the Why

When we refer to blended gifts, we mean a combination of current and future giving—major gifts (now) and planned gifts (later). The value of a blended gift lies in the combined benefits that result from the two giving strategies. If the "science" of a blended gift is fairly straightforward, the "art" lies in the selection of gift strategies that, when combined, most effectively accomplish a donor's goals while providing robust benefits to the selected charities.

Every donor has a unique worldview, personal history, and heartfelt desires. Understanding the motivation and context of each gift is critical to crafting successful blended gifts. Professionals who want to help clients plan and execute blended gifts must engage donors to understand their personal connection to and involvement with the selected charity. Only then is it possible to recommend the most effective combination of strategies that will meet the donor's charitable goals in a meaningful, comprehensive and enduring manner.

When we examine the reasons for combining present and future gifts, it is essential to remember why people give. Donor motivation is complex and there are many variables that factor into this charitable equation. As such, determining appropriate strategies, timing, and amounts will be affected by an individual's preferences and desires.

There are, of course, tax benefits—sometimes significant benefits—but in the end, the donor still ends up with less wealth than they began with. This means that people don't make charitable gifts just to eliminate taxes. While tax reduction is important and often affects the timing of a gift, it is not the only factor in a giving decision.

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Consider some other possibilities:

- Because we live in a society, we are all connected. Frequently, donors choose to help others because it meets a basic need to strengthen the societal ties that bind us all together—a desire to give back, to make the world a better place, to help the less fortunate.
- Others give to charities that are personally significant to them, as a way of bringing about a preferred result or creating a desired impact.
- Still others make a gift to honor or memorialize a beloved family member. A donor might make a gift to a cancer research organization when a relative succumbs to cancer. Another donor might give to a nature conservancy to honor a parent who spent a lifetime supporting conservation of the environment.
- There are also public aspects of giving—a donor's desire for societal approval, recognition or respect—that can provide the fundamental underpinning for making a gift.

No matter what the motivation is, leading a donor through the process of fashioning a blended gift requires knowledge and understanding. For these gifts to succeed, professionals working with donors should be aware of the available gift techniques, opportunities to optimize a gift through selection of specific assets, and ways in which the tax law affects giving choices. Let's take a closer look at these factors.

Giving Techniques: Goals Affect Combinations

When you understand a donor's motivation—private altruism, public recognition, tax savings, estate reduction, or any number of other reasons—it is possible to select giving techniques that best accomplish individual goals.

Charitable Gift Annuities

A charitable gift annuity is an immediate gift that provides tax and income benefits to a donor. It is a contractual agreement between the donor and a qualified charity that is simple to understand and easy to execute. The donor irrevocably transfers cash or property (often long-term appreciated stock) to the charity. In return, the charity agrees to pay a specified amount periodically for the lifetime of one or two annuitants. Donors can use a single gift annuity for a significant gift or establish multiple annuities over time for a series of smaller donations. The minimum gift amount is typically low, making the gift annuity an economical alternative to the more complex charitable remainder trust. It is useful in removing assets from a donor's estate, and the donor qualifies for an immediate income tax deduction.

Charitable Remainder Trusts

A charitable remainder trust (CRT) is a delayed gift that provides immediate tax and income benefits to the donor. The donor transfers property to an irrevocable trust and the trust pays out an income for life (or a period up to 20 years) to one or more beneficiaries. At the end of the trust term, the remaining amount is distributed to charity. A CRT is an important planning tool, often permitting the donor to make a major gift with immediate income tax benefits without losing spendable income.

The donor selects and locks in the payout rate within certain legal limits (5% minimum, 50% maximum, 10% charitable remainder value). By careful selection

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of the trust's payout percentage, a donor can elect to maximize either the charitable deduction or the payout amount.

CRTs come in two forms. A charitable remainder annuity trust (CRAT) pays out a fixed percentage of the trust's initial value. The income beneficiary must receive the required annuity payout each year, so if the trust does not produce any income, the trust principal may have to be invaded. A charitable remainder unitrust (CRUT) pays out a fixed percentage of the trust's annually revalued assets—so if the trust assets rise in value, the payout will also increase. A CRUT comes in four sub-varieties and is very flexible in terms of how income benefits are paid.

Charitable Lead Trusts

A charitable lead trust (CLT) is an immediate gift that provides tax and wealth transfer benefits to the donor. The trust makes annual income payments to a charity for a specified period of years, then passes the remainder to noncharitable beneficiaries (often the donor, spouse, child or grandchild). This type of irrevocable trust is a way to make a "temporary gift" of income to a charity and eventually pass the property to family members, all while reducing overall taxes.

If the remainder assets will return to the donor (a grantor lead trust), the donor may take an immediate income tax deduction for the present value of the charitable interest, but must pay tax on all trust income. If the remainder assets will go to another beneficiary (a non-grantor lead trust), the donor can make use of an estate or gift tax charitable deduction for the charitable gift portion, and will realize savings on capital gains taxes on any appreciation of trust assets.

Regardless of how trust assets are disbursed, the trust agreement must provide for the annual payment to a charity of either a specified "fixed-dollar" annuity payment or a specified percentage of the annually revalued trust assets, or "unitrust" amount. Generally, no payments other than these income payments to charity are allowed until the trust terminates.

Gifts Through a Will - Charitable Bequests

A bequest is a delayed gift with tax benefits. This is a common, simple, and effective way to make a charitable donation. To execute a bequest, the donor specifies in his or her will what property goes to charity. The value of the bequest is deductible by the estate for federal estate tax purposes. The bequest can take many forms, from gifts of specific property to a stated portion or percentage of the estate.

Gifts of Remainder Interests

A gift of a remainder interest in a personal residence or farm is a delayed gift with tax benefits for the donor. This gift arrangement, which can be made with a simple deed, permits a donor to make a very generous deferred gift without any change in income or daily pattern of living. The donor retains the full use, possession and enjoyment of the property for life—the charity has no right to use or control the residence or farm until after the death of the donor and/or other designated beneficiaries. The donor may take an immediate charitable deduction for the gift. In most cases, an individual will donate a remainder interest in the entire property. However, a donor may also take a charitable deduction for a gift of an undivided fractional part of a remainder interest.

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The Wealth Replacement Technique

Some insurable donors would like to make a substantial gift to charity, but feel constrained by concerns that a charitable gift could deprive family members of assets they might need. Wealth replacement is a technique that addresses this natural concern for family financial security. This technique combines a charitable remainder unitrust (CRUT), a life insurance policy, and an irrevocable life insurance trust (ILIT) to allow a donor to make a large, delayed charitable gift and replace the value of the donated assets with the life insurance proceeds.

In a nutshell, the donor funds a CRUT with long-term appreciated property and simultaneously funds an ILIT with a life insurance policy. The donor uses the annual income from the CRUT to make gifts to the ILIT to pay the insurance premiums. At the donor's death, the charity receives the remainder amount in the CRUT and the ILIT receives the policy death benefits. The ILIT trustee then distributes the proceeds to the donor's heirs, replacing the value of the donated assets.

The donor can deduct the present value of the charity's remainder interest in the year the property is transferred to the CRUT. This technique also removes the donated property and the life insurance from the gross estate, and avoids immediate capital gains tax on the appreciated property transferred to the CRUT.

While this technique is more complicated than using only one of the previously mentioned options (say, just a CRUT), it is a powerful estate planning tool. Combined with a current gift of cash or property, this can make a truly impactful and beneficial blended gift strategy.

Actual Gifts: Assets and Timing

No matter which strategies are combined for a blended gift, the donor will also need to select assets for donation and plan the timing of the gift. Each type of asset has a different impact on the donor's tax situation and estate. Here are the more common options:

- **Cash -** Donors receive a tax deduction for the amount of the gift.
- **Appreciated Stock -** Donors receive a tax deduction for the fair market value of the appreciated stock and entirely avoid any capital gains tax on the appreciation.
- **Required Minimum Distributions -** Donors over age 70½ can transfer up to $100,000 per year from an IRA directly to a charity. There is no charitable deduction, but the distribution is excluded from income and counts toward the donor's annual required minimum distribution.
- **Retirement Plan Assets -** Donors can make a charity a beneficiary of assets held in an IRA, 401(k), or other retirement plan. Since these assets are considered

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"income in respect of a decedent" (IRD), it is beneficial to keep them out of the estate. IRD assets are highly taxed and have the potential of being taxed twice—once in the estate and again to the beneficiary (a child, for example). Leaving these assets to charity avoids the possibility of double taxation.

- **Real Estate -** Like appreciated stock, real estate (a residence, vacation home or other property) may be highly appreciated in value. Making a gift of real property gives the donor an immediate tax deduction for the fair market value of the property and avoids any capital gains taxes on the appreciation. This is a good choice for donors who find property ownership increasingly burdensome due to property taxes, maintenance and insurance.
- **Life Insurance -** Donating a policy that has outlived its original protection purpose is an easy way for an individual to give to charity without diminishing the estate. The simplest option is for the donor to make a deferred gift by naming the charity as beneficiary. It is also possible for a donor to make a current gift of an existing policy regardless of whether the policy is fully paid up. If not fully paid, the charity may request that the donor make additional gifts to cover premium costs.
- **Business Interest -** A business interest or privately held stock is often highly appreciated and comes with the same benefits found in donations of real estate or appreciated stock—a sizable tax deduction for the fair market value of the business interest, plus avoidance of capital gains taxes on the appreciation.
- **Artwork and Collectibles -** Valuable tangible assets such as artwork, jewelry, or collectibles are more complicated to donate. The donor must take care to find an appropriate charity willing to accept the asset. A tax deduction is available, but the amount of that deduction depends on whether the gift will be used by the recipient for its charitable purposes (e.g., a painting given to a museum) or whether the recipient will sell the gift and use the proceeds (e.g., a painting given to a conservation group that intends to sell it and use the money). To obtain the full fair market value deduction, the gift must be put to related use—if not, the deduction is subject to a 50% ceiling.

Often, the choice of assets and giving vehicles determines the timing—but not always. And while blended gifts are typically considered to combine the enjoyment of a current gift with a lasting charitable legacy, there are few set guidelines that must be followed to achieve a successful result. With such built-in flexibility, timing really depends on the donor's aspirations, needs, and concerns.

Blended Gifts in Action

Understanding the components of blended gifts is important, but seeing them in action gives a clearer glimpse of what clients can accomplish through a combination of current and future giving. Let's take a look at a few fictional examples.

Creating a Scholarship Fund

Maria Kovacs and her family immigrated to the United States from Hungary when she was five. They struggled to find their place in a country that was very different from their own, and her parents faced many difficulties and disappointments. Still, they worked hard and were able to send Maria to a good university, where she studied painting and art history. After graduation, she moved to New York, and through a combination of talent, charisma and determination, she became a successful artist. She married and had a daughter, and eventually sold her works all over the world.

At 72, her husband has retired from his career in finance and their daughter, at 42, is doing well working at a gallery. Maria continues to create new paintings and sculptures, but she has also spent more time reflecting on her long career. She attributes her success to the university, where professors guided and encouraged her and insisted that she hone her skills. However, she realizes how difficult it was for her parents to pay for her education, and now she would like to give back some of her wealth to help other struggling students.

With her husband's encouragement, Maria talks to the university about creating a scholarship fund for first-generation American citizens. She has an IRA worth $250,000, and she decides to change the beneficiary designation from her daughter to the university, to create an endowment for the scholarship fund. She will then leave her daughter her investment portfolio, which contains many highly appreciated stocks. There are strong benefits to this plan:

- **Avoids double taxation of retirement assets.** Retirement assets are considered income in respect of a decedent (IRD) and are therefore taxed as part of the estate and taxed again to the recipient (in this case, her daughter). But a charity pays no tax on donated retirement assets.
- **Allows her daughter a step-up in basis.** Leaving non-IRD assets to her daughter instead is also wise, as she will inherit the appreciated assets with a step-up in basis.
- **Maintains sufficient liquidity.** Making a gift of cash and securities would have removed much of the liquidity from the estate—liquidity they may need later, or that may prove valuable in paying death-time expenses when Maria dies. It's much harder to access the value in retirement assets.

However, Maria is not entirely satisfied with this endowment arrangement—after all, meeting and possibly mentoring the scholarship recipients would bring her a great deal of joy. Working with the university, she determines that, starting now, she will make annual gifts that will mimic the $250,000 endowment's planned 4.5% payout. By blending a string of current gifts with a larger gift at her death, she is able to fulfill all her goals—support students new to the country, be a presence in the scholarship program during the remainder of her life, and make efficient use of her assets at death to fund the endowment and provide her daughter with a sizable inheritance.

Naming a Museum

Curt and Jan Mercer share a passion for ethnology. After meeting in a graduate program for anthropology, they devoted their lives to collecting, comparing and analyzing the life histories of people from many different parts of the world. When their alma mater set out to raise funds to build a new museum for cultural anthropology, they approached Curt and Jan. The Mercers were definitely interested. Not only that, they wanted to leave an enduring mark on the university. The school encouraged their substantial generosity by offering to name the museum after them in honor of their many years of important work in the field.

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To accomplish their major gift, the Mercers made a commitment of $20 million. They gave the first $7 million in stages through outright gifts of cash and appreciated securities plus a structured gift of their Long Island vacation home. These current gifts allowed them immediate tax deductions and helped them avoid paying significant capital gains taxes on the appreciated stock and the real estate. The remaining $13 million consisted of two future gifts—a bequest of $3 million and $10 million in a charitable remainder trust, which will first pay an income to their daughter for life.

Their gifts provided tax deductions, reduced their estate (lowering their estate tax bill), and avoided substantial capital gains tax. But most importantly to them, the Mercer Museum of Anthropology will bring honor to their family for generations to come.

Enhancing a Payout Strategy

Donors who have embarked on a charitable strategy can sometimes enhance their gifts by altering a payout or changing a beneficiary. Let's look at two examples.

Example: After Sandra's mother died of breast cancer, she created a charitable remainder trust in her mother's memory to benefit a cancer research charity. The trust was set up to make payments to Sandra and her husband for life, with further payments to their son after their deaths. Soon after, her husband and son were killed in a tragic car accident, leaving Sandra with significant life insurance proceeds. A few years later, the cancer research charity asked Sandra to participate in a capital campaign. She no longer needed the income from the charitable remainder trust, so she decided to enlarge her gift by transferring the value of her life income interest in the trust to the charity. Not only did she increase her gift and gain new tax deductions, but she added a present-gift component. This allowed her to enjoy the results of part of her contribution during her lifetime, while the majority of the gift (the remainder in the trust) would still take place when she dies.

Example: Ten years ago, Benjamin created a charitable lead trust to benefit his alma mater, State University. His attorney wisely drafted the trust to provide the trustee discretion regarding the application of income benefits. The trust initially paid benefits for the construction of a new fine arts building. When State University decided to launch a campaign to fund a faculty fellowship in the fine arts department, Benjamin was interested. He made State University the beneficiary of his sizable 401(k) account to fund the fellowship, but since this was a future gift, he also wanted to contribute something now, when the school really needed it. Thanks to the flexibility built into the charitable lead trust document, the trustee was able to restructure the lead trust annual payments to accomplish Benjamin's new goal.

Conclusion

Leo Baekeland invented the first fully synthetic plastic by accident. He was trying to create an inexpensive substitute for shellac, but found that by blending the two compounds with wood flour, asbestos or slate dust, he created a material both moldable and sturdy. He called it "the material of a thousand uses."[4]

As we've seen, blended gifts have almost as many uses, and they share the flexibility and strength of Baekeland's newly invented plastic. Planners and other professionals

can help clients accomplish varied and personal objectives by combining the appropriate gift techniques. With a basic knowledge of the options and an understanding of each client's situation, needs and desires, advisors can help donors successfully implement blended gifts with benefits to both the donor and the charity.

ENDNOTES

1 Chemical Heritage Foundation website, William Henry Perkin. See http://www.chemheritage.org/discover/online-resources/chemistry-in-history/themes/molecular-synthesis-structure-and-bonding/perkin.aspx

2 How Products Are Made: Dynamite. See http://www.madehow.com/Volume-2/Dynamite.html

3 Velcro Industries website. See http://www.velcro.com/about-us/history. VELCRO® is a registered trademark of Velcro Industries B.V.

4 Conflicts in Chemistry: The Case of Plastics. See http://www.chemheritage.org/discover/online-resources/conflicts-in-chemistry/the-case-of-plastics/all-history-of-plastics.aspx

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