Scripps Heritage Planner

An Income, Estate and Gift Tax Newsletter for Professionals
from the Office of Gift Planning at Scripps Health Foundation

SUMMER/FALL 2016

THE ART AND SCIENCE OF BLENDED GIFTS

IN THIS ISSUE:

Scripps

scrippsheritage.org

YOU ARE INVITED!

Summer Social & Networking Event For Professional Advisors

Friday, September 16, 2016
5:00 p.m. to 6:30 p.m.

Enjoy food, drinks, fun and Behind-the-scenes tour of the new **Barbey Family Emergency and Trauma Department** before it opens.

Location:
Prebys Cardiovascular Institute
north courtyard lobby
9896 Genesee Avenue
La Jolla, CA 92037

Please RSVP to:
giftplanning@scrippshealth.org
by Tuesday, September 13

Scripps Health Foundation

Serving the Fundraising Needs of the Following Scripps Health Facilities and Programs:

Scripps Health   Scripps Memorial Hospital La Jolla   Scripps Green Hospital   Scripps Clinic
Scripps Mercy Hospital & Mercy Hospital Foundation   Scripps Mercy Hospital Chula Vista
Scripps Memorial Hospital Encinitas   Scripps Home Health Care Services
Scripps Hospice   Scripps Whittier Diabetes Institute

Care Lines:

Cardiovascular   Orthopedics & Spine   Oncology and Cancer Care
Neurosciences   Women & Newborns   Diabetes   Primary Care
Behavioral Health & Drug and Alcohol Services   Hospice

Our Services

Immediate Telephone Consultations   Charitable Deduction Calculations   Summary of Benefits
Flow Charts and Graphs   Private Client Meetings   Presentations at Your Office   Seminars for Clients

Our Website:

Resources for Estate Planning Professionals
Please visit us online at www.scrippsheritage.org and click on the link for Professional Advisors to find helpful tools and information.

Access complimentary charitable gift planning research sources with Crescendo GiftLaw Pro© by clicking on the link to Charitable Law References.

Access the Deduction Calculator from Crescendo GiftLaw Pro© to calculate tax deductions for clients or call us and we'll be happy to prepare full customized illustrations for you.

Read Advisor Articles to spark creative charitable gift planning ideas for your clients.
Keep up to date with the link to Washington News

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Sign up for our weekly eNewsletter to receive timely news from Washington, estate planning and tax articles, donor stories and Scripps news.

Scripps

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.
- 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.[2]

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 Scripps Heritage Planner 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 like Scripps Health Foundation.

Blended Gifts: The How and the Why

When we refer to blended gifts, we mean a combination of current and future giving—major gifts (writing a check now) and planned gifts (making a distribution from a planned giving vehicle 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 present charitable gifts while they are alive only 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. 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 or help future generations.
- Others give to charities that are personally significant to them because of their experience with the organization, 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 clinical cancer research at an organization when a relative survives cancer because of the great care by a physician and care team. 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 and charities 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 specific giving choices. Let's take a closer look at these factors.

Giving Techniques: Donor's Goals Affect Blended Gifts Combination

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

Immediate Gift

An immediate gift is accomplished by either writing a check or donating stocks or mutual funds to the charity. The organization can immediately use the money to fund a need and the donor receives an immediate income tax deduction for the amount of the gift. Donating real estate and business interests can be tricky.

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 annually for the lifetime of one or two annuitants based upon the donor's age(s) and other factors. 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. The donor qualifies for an immediate income tax deduction and it is useful in removing assets from a donor's estate.

Charitable Remainder Trusts

A charitable remainder trust (CRT) is another delayed or deferred gift that provides immediate tax and income benefits to the donor. The donor transfers property to an irrevocable trust, the trustee sells the property and invests the proceeds in income producing investments. The trustee makes payments for life (and/or a period of up to 20 years) of a fixed percentage of the trust investments each year to one or more beneficiaries. At the end of the trust term (one life, two lives or up to 20 years), 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. Many times, the new investments from the proceeds of the sale earn more income than the property which was originally transferred to the trust.

The donor selects and locks in the payout rate within certain legal limits: 5% minimum, 50% maximum, requires at least a 10% charitable remainder value. By careful selection of the trust's payout percentage, a donor can elect to maximize either the charitable deduction or the payout amount.

CRTs come in several 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 would 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 and if the trust assets decrease in value, the payout will also decrease. 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 such as Scripps Health Foundation for a specified period of years, then passes the remainder to noncharitable beneficiaries (often the donor's child or grandchild or back to the donor or donor's spouse). 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 income and estate taxes and removing the property from the donor's estate for estate tax purposes.

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** (an "annuity" amount) or a **specified percentage of the annually revalued trust assets** (a "unitrust" amount). Generally, no payments other than these income payments to charity are allowed until the trust terminates.

Gifts Through a Will or Trust - Charitable Bequests

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

Gifts of Remainder Interests – Life Estates

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 based upon the present value of the remainder interest. The Donor continues to be responsible for maintaining, insuring and paying the property taxes on the property. The Donor may rent the residence or farm and keeps the rental income. After death, the property passes to Scripps Health and the gift is complete.

The Life Estate Gift Annuity

The Life Estate Gift/Annuity works like a life estate, with the additional feature that Scripps Health agrees to pay an annuity based upon the present value of the remainder interest of the residence or farm. The amount of the annuity is determined by the value of the remainder interest multiplied by the annuity rate, which is based upon the age at the time of the gift. The Donor retains the full use, possession and enjoyment of the home or farm for the remainder of his, her or their life/lives. The same Donor rules apply for responsibility for property taxes, insurance and maintenance and the ability to rent the property. Not all charities accept and issue this type of gift arrangement. Scripps does not accept all properties.

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 in the future. 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 that would otherwise go to the family with the life insurance proceeds to family members.

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 family, replacing the value of the donated assets in the CRUT.

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.

What to Give: 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 on the date the stock is transferred to the charity 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 designate a charity as the beneficiary of assets held in an IRA, 401(k), 403(b) or other retirement plan. Since these assets are considered "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 when withdrawn (by a child, for example). Leaving these assets to charity avoids this double taxation.
- **Real Estate—**Like appreciated stock, real estate (a residence, vacation home, rental property, apartment complex, commercial property, vacant land 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. Gifts of real estate to charity are a good choice for donors who find property ownership increasingly

burdensome due to tenant problems, management hassles, property taxes, maintenance and insurance. Not all charities are equipped to accept real estate. Scripps Health has a real estate department and is happy to work with donors and their professional advisors to accept most types of real estate.

- **Life Insurance—**Donating a life insurance 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 gift of an existing policy (a paid-up policy) since a policy with ongoing premiums causes complications.
- **A Business Interest—**Privately held stock, a limited liability company, limited partnerships, corporations or other business interests are often highly appreciated and come 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.

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 a few set guidelines that must be followed to achieve a successful result. With such built-in flexibility, timing really depends on the donor's objectives, 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 deferred giving. Let's take a look at an example.

Creating a Graduate Medical Education Endowment

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 and then to medical school, where she studied and received her M.D. degree. After graduation and her residency, she competed for and received a prized fellowship at a hospital in La Jolla, California. After completion of her fellowship she went to work as a cardiologist for the La Jolla hospital. She married and had a daughter, and eventually developed and patented a heart device which saved many lives.

At 72, her husband has retired from his career in finance and their daughter, at 42, is doing well working as a CPA. Maria continues to teach and lecture, but she has also spent more time reflecting on her long career and the opportunities which were offered to her. She attributes her success to the hospital where she completed her fellowship training and their support of her work. However, she realizes how difficult it was for her parents to pay for her education, and she knows that the fellowships are solely funded through philanthropy. She remembers how she struggled and wants to make sure that those residencies and fellowships are available for future young physicians and would like to give back some of her wealth to endow those fellowships forever at the hospital she so loves.

With her husband's encouragement, Maria talks to the hospital's gift planning officer about creating a Graduate Medical Education Endowment in Cardiology in honor of her parents. She has an IRA worth $3,000,000, so she decides to designate the hospital as beneficiary of $2,500,000 of the IRA to create the endowment. The endowment will pay out 5% each year which will be enough to fund the $125,000 stipend for the fellowship. She will then leave her daughter her investment portfolio, which contains many highly appreciated stocks. The stocks will receive a step up in basis upon her death. 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 for the fellowship 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 Hospital, she determines that, starting now, she will make annual gifts that will mimic the $125,000 endowment's planned 5% payout with yearly $125,000 gifts of appreciated stock. By blending a string of current gifts with the endowment at her death, she is able to fulfill all her goals—support graduate medical education, be a presence in the fellowship 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 Hospital Wing

Curt and Jan Mercer share a passion for emergency and trauma medicine. After meeting in college, they married and had three children. Their daughter was in a car accident when she was 10 years old and received lifesaving care in the trauma unit at their local hospital. When the local hospital set out to raise funds to build a new state of the art emergency and trauma department, they approached Curt and Jan. The Mercers were definitely interested. Not only that, they wanted to leave an enduring legacy for the hospital in honor of the physicians who saved their daughter's life. The hospital encouraged their substantial generosity by offering to name the trauma unit after them in honor of the physicians.

To accomplish their major gift, the Mercers made a commitment of $5 million. They gave the first $1,000,000 million over a five year period through outright gifts of appreciated securities of $200,000 per year plus two deferred gifts valued at $4 million. These current gifts of $200,000 per year for five years allowed them to see their immediate gifts at work, gave them immediate charitable income tax deductions and helped them avoid paying significant capital gains taxes on the appreciated stock. The remaining $4 million consisted of two planned gifts—a bequest of the La Jolla Cove residence valued at $2 million and $2 million in a charitable remainder trust funded with appreciated rreal estate.

Their gifts and the CRT provided immediate income tax deductions, reduced their estate (lowering their estate tax bill), and avoided substantial capital gains tax on the appreciated real estate in the CRT and the appreciated stock. But most importantly to them, the Mercer Family Trauma Department at their local hospital in honor of the physicians who saved their daughter's life will memorialize a legacy 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 new 360¡ state-of-the-art Cancer Care Center at Local Hospital devoted to patient centered care for breast cancer patients. The trust was set up to make payments to Sandra and her husband for life. Soon after, her husband was killed in a tragic car accident, leaving Sandra with significant life insurance proceeds. A few years later, the Cancer Care Center at Local Hospital 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.

Conclusion

Leo Baekeland invented the first 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."[3]

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 a current gift with one or more planned gifts. With a basic knowledge of the blended gift options and an understanding of each client's situation, assets, 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 Velcro Industries website. See http://www.velcro.com/about-us/history. VELCRO® is a registered trademark of Velcro Industries B.V.

3 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

Upcoming Gift Planning Seminars

All presentations are held in the **Founder's Room** at Schaetzel Center for Health Education at Scripps Memorial Hospital La Jolla, located at 9890 Genesee Avenue, La Jolla, CA 92037.

Complimentary lunch and validated self-parking are provided.

MCLE credit is available for those who qualify.

To make a reservation please email to: giftplanning@scrippshealth.org or call 858-678-7120.

Confirmed reservations are required.

Friday, September 16, 2016 ~ 3:00 to 5:00 p.m.

Nuts and Bolts of Drafting, Funding, Administering and Terminating Charitable Remainder Trusts

NEW: A special two hour interactive workshop for new and experienced attorneys

Presenters: Philip J. Sullivan, Esq. and Jennifer M. McGibbons, Esq., Sullivan McGibbons & Associates LLP

Friday, September 16, 2016 ~ 5:00 to 6:30 p.m.

End of Summer Professional Advisors Reception and Networking Event

Come and join us for **food, drinks, fun and behind** the scenes tours of the **new** ***Barbey Family Emergency and Trauma Department*** before it opens its doors.

Location: **Prebys Cardiovascular Institute** – north lobby courtyard – 9896 Genesee Avenue, La Jolla, CA 92037

Wednesday, October 5, 2016 ~ Noon to 1:30 p.m.

Fixing Broken Trusts with Trust to Trust Transfers

Presenter: Nancy G. Henderson, Esq. Henderson Caverly Pum & Charney, LLP

Wednesday, November 2, 2016 ~ Noon to 1:30 p.m.

Thwarting the Trips and Tumbles Through the Title Trenches

Presenters: David C. Anderson, Esq. of Anderson & Reynard, LLP
Matthew Helbert, Vice President, Underwriting, First American Title

Wednesday, December 7, 2016 ~ Noon to 1:30 p.m.

Recent Developments, Year End Planning and New Laws for 2017

Presenter: Meredith G. Alcock, Esq., Abbene & Alcock

Scripps

Mailing address:
P.O. Box 2669
La Jolla, CA 92038

Physical address:
4275 Campus Point Court
San Diego, CA 92121-1513

scrippsheritage.org

David E. Williams, Esq.
Senior Director of Gift Planning
858-678-6359
williams.dave@scrippshealth.org

Janet H. McDonough, Esq.
Director of Gift Planning
858-678-6344
mcdonough.janet@scrippshealth.org

If you are not already receiving our weekly eNewsletter, you may sign up easily on our web site.