THE CHARITABLE ALTERNATIVE

Spring 2014 Edition

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SOUTHWEST INITIATIVE FOUNDATION

Creative estate planning techniques using charitable alternatives to achieve your clients' financial objectives

2014 Planning Strategies Coming Off A Record Market Year

What a year the investment markets had in 2013!

- The S&P Index was **up 29.6 percent** for the year.
  - Largest jump in 16 years
- The DOW was **up 26.5 percent** for the year to 16,576.
  - Largest gain in 18 years
- The Nasdaq was **up 38.2 percent** to 4,176.

Now, that's the way to "ring in" a new year. So, what actions are you advising your clients to take as this year unfolds?

Of course, the answer to that question depends on the clients' age, investment objectives, tax bracket, holdings and many other factors.

However, generally speaking, it's time to **lock up some of the profits** gained over the past year and to **rebalance the portfolio** in keeping with your clients' stated objectives and desired diversification.

The need for **"rebalancing"** can escape those failing to re-access their portfolios in a timely manner. Many planners remember the tech wreck of the 1980s and how many clients who had allocated 15 to 25 percent of their holdings to growth equities failed to notice that the explosion in Microsoft, Oracle, Intel, EMC, etc. share values

had ballooned these holdings to 60 percent of their portfolio totals. Not fun to lose 40 percent of your nest egg at age 50+.

As to **profit-taking** in 2014, it can be very expensive for two reasons. First, with 100 percent or greater price jumps in many issues, the size of some of these reportable capital gains are substantial. To name a few Nasdaq winners:

Tesla	+344 percent
Netflix	+298 percent
Micron Tech	+243 percent
Celgene	+115 percent
Facebook	+105 percent
Gilead Sciences	+104 percent
Yahoo	+103 percent

Second, thanks to the American Taxpayers Relief Act of 2012, the federal marginal tax rates for long-

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Let's Get Down To Cases

Where Can These Strategies Help Your Clients in 2014?

Let's take the client who bought Tesla Motors (TSLA) one year ago. A high-end electric car sounded like a winner and was it ever. He/she paid $33 per share and at the close of market in January, it closed at $176.68 per share. Working in round numbers, that's $143 of gain per share. If our client lives in Minnesota, he or she is looking at roughly one-third of that gain going to the State and Federal government.

Consider those charitable alternatives:

1. Since held "long-term," our client could **gift some shares outright** to his/her favorite charity, taking the full market value ($176+) off this year's taxes as a charitable deduction. (This deduction is limited to 30 percent of the client's AGI for the year with any surplus carried forward for five more years.) Remember, our client paid $33 per share, realizes no taxable gain and is deducting $176 per share...not bad economics for a generous act.

   Great for that 70+ year old senior client who is forced to take mandatory withdrawals from his/her qualified retirement plan and, as a result, faces serious bracket creep.

   Some planners would take this strategy further with a **gift some, sell some** plan. For the client desiring cash lump-sums, this combination would allow profit-taking while mitigating taxes in the current year. Again, the income smoothing is allowed by offsetting reportable gains with charitable deductions.

2. Contributing some shares to a **Charitable Remainder Trust** is a great strategy for the client seeking regular income payouts for a term of years. Consider the client who is retiring early and has a five- or 10-year gap before social security or qualified plan benefits begin. Some of these shares could be contributed to a CRT designed to pay them income for a five-, seven- or 10-year term period before the remainder flows to the donor's named charities.

   Consider the difference. Rather than selling shares, paying the taxes, then taking what's leftover and trying to find a safe and sound investment that yields more than 1.5 percent, your client can contribute the shares to a CRT and **the full untaxed market value will fund payouts at the trust's specified rate, e.g., 5 percent per year on a quarterly basis.**

A Word About Diversification

Not only does the CRT allow relief from current capital gains taxation but the trustee can sell and diversify these values into a balanced portfolio for the long term. Here's the answer to rebalancing an overgrown position and spreading out the values.

If those seniors who were victims of the tech wreck in the 1980s had only chosen to utilize a Charitable Remainder Trust and reinvested some of those Microsoft or EMC profits in a diverse way, it would have made retirement easier.

For additional planned giving resources and ide

Charitable Gift Annuities For Seniors With Modest Positions

To draft and fund a Charitable Remainder Trust the economics generally require a contribution of $100,000 or more. On the other hand, a Charitable Gift Annuity requires no trust document (just a simple two-page agreement) and can be issued by Southwest Initiative Foundation for amounts of $5,000 or more.

Additionally, these plans can be drafted to pay immediate income to the donor or defer the income to some future specified date or on a "wait and see" basis where the donor is able to select the start date in the future as desired.

Talk about flexibility. Here's a plan where the senior can lock up his securities profit now on a tax-favored basis and take a fixed lifetime income later when he/she desires to supplement their retirement cash flow. Of course, these plans can also be funded with cash or a combination of cash and appreciated securities.

Frankly, when we look at the yields on so-

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term capital gains have increased to 20 percent, which together with a Minnesota tax rate of 9.85 percent (which makes no distinction for capital gain) and increased further by Affordable Care Act surtaxes reaches a **33.65 percent combined maximum on these profits.** That's a chunk!

Remember the concept of "income smoothing" (our last newsletter) and the need to avoid spikes in reportable income under this new tax law that has raised the marginal tax rates at the higher income levels.

Simply said, "don't go there."

What? On one hand we're advising some profit-taking and rebalancing and on the other hand, we're saying don't go there tax wise.

Well, there is an alternative. You guessed it. It's the **Charitable Alternative.**

If that stock position has been held long-term (one year + one day), it may be contributed to a plan which ultimately flows to a qualified charity or charities with no realization of capital gain at time of transfer.

It could be an outright gift to charity with deduction for the full market value and no recognition of gain OR it could fund a Charitable Remainder Trust (CRT) paying the donor income on the full market value for a term of up to 20 years or their lifetime.

In the case of the CRT, a portion of each income payment would be taxable as a capital gain over the term of the trust but consider how that mitigates the effects of the tax. It is the personification of "income smoothing."

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called safe instruments like Bank Certificates of Deposit or Treasury Bills, retirees can double or triple their income returns with charitable gift annuities.

Now, it's not an apples-to-apples comparison because with the annuity you give up liquidity and ultimately the principal, but if fixed, dependable, lifetime income is a goal...here is one answer.

Point is, it's not the whole answer, but it certainly can be a valuable part of your senior clients' cash flow. And, it can be part of their legacy planning with the remainder funding an important community resource—like Southwest Initiative Foundation, any of our 100+ partner funds, or other southwest Minnesota causes that are important to your clients—with ongoing financial support in their family name.

Please call or e-mail me if you would like to discuss any of the concepts presented.

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