Rewards of Financial Planning

You and your family can reap many benefits from careful financial planning. Congress has provided a number of financial planning techniques that can enable you to improve your immediate financial situation and that of your family in future years. Ask yourself now if you and your family are currently receiving all the benefits available to you, and if your family will continue to be as financially secure after your retirement or death. To assist you in determining if you are taking full advantage of available financial planning techniques, this booklet will examine financial planning from three interrelated viewpoints:

(1) Your present income and income taxes;

(2) Your retirement income and the taxes you'll pay after retirement; and

(3) Your estate distribution and estate tax liabilities.

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MINIMIZING YOUR INCOME TAX LIABILITIES

As your income steadily increased during the past years, you probably became aware that your income tax rates also increased dramatically. For example, if you are in a 24% tax bracket, you will keep only $760 of the next $1,000 you earn. If you move into a 32% tax bracket, you will keep only $680 of the next $1,000 you earn.

"Are there ways to combat high taxes?" several of our friends have asked. Yes – deductions, exemptions, credits and exclusions are often available if you will plan your financial affairs. (Also vitally important are those financial planning techniques that allow you to defer, convert or divert portions of your income. These techniques will be discussed in the section dealing with retirement income.)

FAMILY GIFTS CAN REDUCE INCOME TAXES

Many people are unaware that they can increase their family's income by making gifts of income-producing property to low tax bracket family members. Consider Mr. and Mrs. A, who owned stock valued at $125,000. The stock had a yield averaging 4% annually. In their 32% tax bracket, the dividends are taxed at 15%. They keep only $4,250 of the $5,000 income from the stock. Mr. and Mrs. A decided to make a

gift of the stock to their son, a recent college graduate who is in the 12% tax bracket[1] and the dividends will be 100% tax free to him. Gifts of income-producing property also can make sense when providing for an aged parent or other relative.

If you have not yet begun a continuing program of making family gifts, you probably need to reexamine your financial planning.

CHARITABLE GIFTS MAKE TAX SENSE

Every dollar you give to charity is tax deductible (if you "itemize" your deductions).[2] If you are in a 24% tax bracket,[3] a gift of $1,000 actually costs you only $760.

Since the value of the charitable deduction depends on your tax bracket, plan to make larger gifts in those years when your income is at its highest. Doing so will reduce the real cost of your gift after taxes are considered.

SPECIAL CONSIDERATIONS FOR APPRECIATED PROPERTY

When you sell stock that has gone up in value, you are taxed on your profit. Net gain on the sale of stocks held more than 12 months is taxed at 20% for taxpayers in the 37% tax bracket and 15% for taxpayers in the 22% to 35% brackets.[4] A 3.8% net investment income tax also applies to taxpayers when modified adjusted gross income reaches $200,000 (singles) or $250,000 (couples). Net gains on property held one year or less are taxed at the taxpayer's highest tax rate (up to 37%). Long-term gains (on assets held more than one year) are favored for purposes of charitable contributions.

While cash gifts provide substantial tax benefits, gifts of appreciated property may be even more attractive from a tax viewpoint. If you sell your long-term appreciated property, you will incur a capital gains tax and possibly an investment income tax. However, you may give us your appreciated property and usually pay no capital gains tax.[5] Further, your charitable deduction is based on the fair market value of the property – not on the original cost of the property to you.

INVESTMENT PLANNING WITH FAVORABLE TAX CONSEQUENCES

To heighten the success of your investment program, consider including the following tax points in your planning:

- If you incur large capital gains, you may want to establish offsetting capital losses. For example, if you have $25,000 of long-term gains and you own stock in which you now have a $10,000 paper loss, a sale of the loss stock will help offset the capital gain.
- In planning your estate, remember that growth stock that you leave to your heirs can completely escape capital gains taxes. They will take a new "stepped-up" basis in the stock.
- Plan the tax consequences of your stock transactions before year's end. You may find it advantageous to take certain steps at year's end – primarily for tax reasons.

Do you have a continuing program of investment management? If not, you may not be receiving the highest possible return on your investments.

TAKING ADVANTAGE OF OVERLOOKED DEDUCTIONS

Do you use part of your home exclusively as an office? If your home qualifies as your principal place of business, you can generally deduct part of your insurance and home maintenance expenses – plus depreciation – as costs of doing business.[6]

Many taxpayers do not realize the broad scope of the deduction for medical expenses. Your extraordinary medical expenses[7] are deductible. But you can also deduct the cost of transportation primarily for medical care.[8]

Don't overlook the deduction for volunteer work for a charity. Your unreimbursed out-of-pocket expenses are deductible – including costs of transportation which can be itemized or deducted at a flat rate.

If you have sold your home in the past year, don't forget to include the prepaid real estate taxes, if any, that you gave the buyer as a credit at closing.

These are only a few of the ways you may be able to reduce your current income taxes. If any of these ideas seem to be relevant to you, financial planning may be the answer.

PLANNING FOR A MORE SECURE RETIREMENT

Retirement should be a time of reward and relaxation, an opportunity to enjoy the fruits of your life's work. With careful planning before retirement, you can enjoy the rewards of retirement. But you may want to take steps now to delay the receipt of income until you are retired and no longer in a high tax bracket.

Social Security and company pensions or other qualified retirement plans can provide an important foundation for retirement. Three additional ways to help assure a secure retirement are by deferring income, diverting income and converting income.

QUALIFIED RETIREMENT PLANS

There are several types of tax-favored retirement plans that encourage individuals to set aside more money for retirement:

- Company pension, 401(k), annuity, 403(b), profit-sharing or SIMPLE plans – for employees, including employee stockholders;
- Self-employed plans – generally permitting tax-deductible contributions on behalf of self-employed persons and their employees of up to 25% of that person's income;[9]
- Individual Retirement Accounts (IRAs) – in which employed and self-employed persons and nonworking spouses may place funds each year.[10] Income tax deductions are available for workers not covered by employer retirement plans, for nonworking spouses and for those who are covered by employer plans but are below certain income ceilings. Nondeductible contributions also may be made to Roth IRAs. Withdrawals are tax free, if made after age 59½ or for qualified purposes before age 59½, such as purchase of a first home.[11] Roth IRAs are phased out for persons with incomes over $196,000 (joint returns) or $135,000 (individuals).[12]

All of these plans provide a current shelter for the income earned on your retirement funds.

DEFERRING PART OF YOUR INCOME

A traditional way to minimize income taxes has been to defer part of your income until a year when you are in a lower tax bracket. That may happen at retirement. This is what you are doing when you participate in a qualified retirement plan. By deferring part of your income, you also defer paying the tax on that portion of your income.

Deferring income is a tax planning technique that works well when tax rates climb. Many people could be in the 37% tax bracket during their peak earning years, and then drop to the 24% or 32% brackets at retirement. Furthermore, deferral of income can permit the tax-free accumulation of wealth – which means your savings can grow faster. A simple example is U.S. savings bonds, in which the interest can accumulate tax free until you cash the bonds. Interest on a savings account, by comparison, must be reported (and taxed) every year, leaving you with less money for your nest egg.

CONVERTING YOUR INCOME

Examine your investments. Would it be more advantageous to invest for dividends or capital gains, both of which are taxed at only 15% or 20%? Or convert dividend income into tax-exempt income? Your top tax rate will be a determining factor. Capital gain income is attractive because taxes on assets held more than 12 months are capped at 20%. Both capital gains and dividend income are subject to the 3.8% investment income tax for taxpayers at certain income levels. There are many possibilities for converting your investments. Check with your tax adviser or investment counselor.

Executives will want to consider taking maximum advantage of employee "fringe benefits" such as health insurance, sick pay, group life insurance, pension plans, etc. Converting fully taxable "straight" compensation into tax-free fringe benefits can be wise tax planning.

DIVERTING INCOME TO A FAMILY MEMBER

Another way to minimize income taxes immediately and help provide additional security for retirement is to divert part of your income to another taxpayer in a lower bracket.

Congress has sharply curtailed the opportunity to shift income to children under age 19 (or 24 for full-time students)

by taxing investment income over a certain level at their parents' tax rate.[13] But there are planning possibilities remaining. Remember that adult children often send money to aged parents and that it may be cheaper to give the parent income-producing property rather than a check every month. The parent would probably bequeath the property back to the child, which would have the added benefit of increasing the child's basis in the property – unless the parent dies within a year of the gift. The property possibly will return to you while you are retired and in a lower tax bracket.

PLANNING FOR THE FEDERAL ESTATE TAX

Of the three areas of planning – present income planning, retirement income planning and planning for the federal estate tax – perhaps the most overlooked is the area of planning for the federal estate tax.

Everything you own,[14] and some of the things you don't own,[15] may be subject to the federal estate tax – your stocks and bonds, your home, your business interests, your bank accounts, retirement benefits, your real property, even your wristwatch. And the tax will be imposed on the fair market value of your assets at the time of your death – not on the cost of the assets to you.[16]

For example, many people overlook life insurance as an asset. The full value of every insurance policy on your life will be subject to the estate tax – no matter who the beneficiary may be – if you have any right to change beneficiaries, to borrow on the policies, to cash them in or to exercise any other incidents of ownership.[17]

In making a preliminary estimate of your potential estate tax liability, assume that one-half of all property owned jointly with your spouse will be taxable at your death.[18] If the other joint owner is not your spouse, all the property may be taxed in your estate if you die first.

To help determine if you need to begin planning for the federal estate tax, add up the market value of your assets.

Stocks and bonds	$ ______________
Mutual funds	$ ______________
Notes and debts owed to you	$ ______________
Personal residence	$ ______________
Other real estate	$ ______________
Bank accounts and cash	$ ______________
Certificates of deposit	$ ______________
Business interests	$ ______________
Retirement accounts	$ ______________
Personal property	$ ______________
Life insurance	$ ______________
Employee death benefits	$ ______________
Jointly owned property	$ ______________
Annuities (death benefit)	$ ______________
Other taxable property	$ ______________
Total assets	$ ______________

Note: The preceding list is made up of only those assets that are obvious. You should be aware that there are many hidden assets.[19]

To determine the approximate amount of estate tax your estate will be liable for, subtract from the total of your assets all debts and mortgages that will be payable by your estate. In addition, funeral costs can be subtracted from your total assets.[20] Finally, add in the amount of taxable gifts you made after 1976.[21]

Total assets (gross estate)	$ ________
Minus debts and settlement costs	$ ________
Plus taxable lifetime gifts[21]	$ ________
Amount subject to estate tax	$ ________
Minus estate tax "exemption"	$ ________
Taxable amount remaining	$ ________
Estate tax[22]	$ ________

In addition to any potential federal estate tax liability, many states impose estate tax on the value of the estate or inheritance taxes, which are based on the relationship of the recipient. Your estate plan should take state taxes into consideration.

The amount of federal estate tax your own estate will pay can be alarming – if you have not taken the time to carefully plan your estate.

Even more distressing can be the effect of a double tax. Consider the case of Daniel, a widower whose estate is subject to tax. At his death, his estate will pass to his sister, who could also have an estate subject to tax. When his sister dies ten years later, the same property could be taxed all over again.

REDUCING THE FEDERAL ESTATE TAX

How can you cut down your estate tax liability? Don't overlook two important deductions – the marital deduction and the charitable deduction.

The marital deduction – available only if you are married – allows you to leave part or all of your estate to your surviving spouse, free of estate tax.[23] For example, if Sam has an estate of $12,000,000 and he leaves it all to his wife Sara, Sam's estate will not be taxed.

If you are married, should you leave your entire estate to your spouse in order to escape federal estate tax? Portability allows a surviving spouse to use the unused estate tax credit of his or her deceased spouse. This allows a married couple to shelter up to $22.36 million in 2018, without the need for a trust at the first spouse's death. An estate tax return must be filed, even if no estate tax is owed, for the surviving spouse to elect to retain the unused estate tax credit.

Portability is limited in situations where an individual outlives more than one spouse.

Even without estate tax, should spouses leave everything to each other? It may be wiser not to, especially if either of you have children from a previous marriage or other family you wish to benefit at your death. You should also consider whether your spouse is physically and mentally able to manage his or her affairs and how assets can best be preserved to last a lifetime.

The charitable deduction allows you to deduct for federal estate tax purposes every dollar you give to charity.[24] This deduction is allowed for both outright bequests and deferred bequests. For example, Shirley is a single woman with an estate of $13 million. Assuming her estate will be subject to federal estate taxes at her death, if she leaves us $3 million in her will, her reduced taxable estate of $10 million completely avoids estate taxes. Thus Shirley is able to make a bequest of $3 million at a reduced after-tax cost.

By combining the marital and charitable deductions, you can avoid tax on an estate of any size.

WHAT ABOUT STATE ESTATE TAXES?

Even if you won't owe federal estate tax, your estate may face state estate taxes.

Some states impose inheritance taxes, in which heirs are divided into beneficiary classes. Those with the closest relationship

typically receive larger exemptions and pay tax at lower rates. Distant relatives, or people unrelated to you, are taxed more heavily. Several states impose an estate tax similar to the federal estate tax, but on estates of much smaller size. States generally exempt charitable bequests from inheritance tax or provide charitable deductions from state estate tax. Ask your advisers about the state estate tax situation in any state where you own property.

TRUSTS – CORNERSTONE FOR EFFECTIVE ESTATE PLANNING

By creating one or more trusts you may be able to insulate your property from double estate taxes, as well as attain various personal planning objectives. Trusts are highly flexible forms of property ownership that permit you to control the use and disposition of your property for many years to come – even for future generations.[25]

Usually a trust will have at least two beneficiaries. For example, you may specify that the income from the trust be paid to your spouse for life, with the property to be distributed to your son or daughter at the death of your spouse. Trusts can take many forms – testamentary or living, revocable, sprinkling, discretionary, charitable, etc. Specific information about the many forms and uses of trusts can be obtained from your attorney.

Property placed in a trust generally will not be subjected to the federal estate tax when the beneficiary dies.[26] Consider a widow who wants to leave everything to her daughter. At the widow's death, there may be a federal estate tax liability. At the daughter's death ten years later, there may be another estate tax on what remains of the mother's estate.[27] By leaving her property in trust for her daughter, the widow could eliminate any further estate tax – regardless of future tax law changes.

CONSIDER A CHARITABLE TRUST ARRANGEMENT

A charitable trust permits you to provide security to someone close to you, reduce or eliminate the federal tax burden on your estate and make a generous gift to a worthwhile cause.

Let's take a look at Harold, a widower who has an estate that may be subject to tax. Harold would like to leave the bulk of his estate to his children, and he would like to reduce or eliminate any estate taxes due. However, he also would like to provide an income to his sister for her life, and he would like to make a generous gift for our future if he can do so and accomplish his other objectives as well.

If Harold's estate passes to his children and sister outright, his estate may pay a tax at his death. In addition, his sister may spend her entire share before she dies, leaving her without any income. This plan is not very satisfactory in light of Harold's goals.

Therefore, Harold decides to revise his will in order to set up a charitable remainder unitrust, funded with $1,000,000. How will this help Harold meet his objectives?

- The bulk of Harold's estate will still pass to his children.
- Harold's sister will receive an income of a fixed percent, in this case 5%, of the value of the trust each year ($50,000 in the first year). With good management, the trust assets will grow so that his sister's income keeps pace with inflation. Her income will continue for her life.
- Harold will be able to make a generous gift to benefit our programs because the assets in the trust will pass to us upon the death of his sister.

- Harold also will reduce any tax burden upon his estate by means of a charitable deduction equal to the value of our remainder interest at the date of his death. If his sister is 75 when he dies, his taxable estate will be reduced by $601,090.[28] Any tax on Harold's estate also will be reduced, for added tax savings.

The following table demonstrates how the charitable deduction from a charitable remainder unitrust can reduce your taxable estate.

Representative Tax Deductions from Unitrust Funded with $100,000 Trust for Life of a Single Beneficiary

Age of Beneficiary	5% Payout to Beneficiary	6% Payout to Beneficiary	7% Payout to Beneficiary	8% Payout to Beneficiary
50	$26,331	$20,949	$16,893	$13,812
55	31,854	26,147	21,693	18,196
60	38,066	32,168	27,410	23,552
65	44,858	38,937	34,005	29,880
70	52,289	46,562	41,641	37,403
75	60,109	54,810	50,127	45,980
80	67,743	63,059	58,811	54,954

ADVANTAGES OF LIFETIME TRUSTS

Rather than establish a charitable remainder trust in your will, it may be extremely beneficial to fund such a trust right now, under which you will be paid income for life, with the payments continuing for one or more beneficiaries of your choice.

Because you chose to accelerate your bequest by means of a trust, Congress says you are entitled to a substantial income tax charitable deduction. Depending on how you arrange your trust, many other advantages are possible:

- Increased income for your family
- Capital gains tax avoidance
- Favorably taxed income
- Diversion of income to a family member in a low tax bracket
- Estate tax savings
- Avoidance of gift tax
- Professional investment of your funds
- A hedge against inflation
- Reduced estate settlement costs
- Meaningful support for our future

We would be pleased to provide more information about charitable remainder trusts and other plans that can assist you, your family and future generations.

CHOOSING A FINANCIAL PLANNER

The first contact many people have with a professional adviser is when they decide it's time to protect a young family by establishing an estate plan. Estate planning may lead to broader financial planning. Most people need financial planning, in one form or another, at various times in their lives. Wealthy persons, business owners and others may require more sophisticated planning techniques, but even less affluent individuals usually need assistance to meet financial objectives.

Where should a person turn for advice? The title "financial planner" is used by a variety of advisers, but levels of expertise vary and planners generally are not licensed in the same manner as a doctor or lawyer. You should look for advisers with one or more professional designations:

- A certified financial planner (CFP) has completed courses offered by the Certified Financial Planning Board of Standards. The courses normally take two years to complete and are followed by a five-part exam. The board requires continuing education and several years' experience in the financial planning field.
- A chartered financial consultant (Ch.F.C.) has completed courses from the American College in Bryn Mawr, PA. The courses covers all aspects of financial planning, particularly insurance. A candidate must have three years' financial experience, pass a ten-part examination and take continuing education classes.
- A personal financial specialist (PFS) is a specialty within the field of accounting. It is conferred by the American Institute of Certified Public Accountants to CPAs with three years' experience in financial planning who have passed a comprehensive exam. Continuing education is required.
- The National Association of Personal Financial Advisers (NAPFA) requires its members to have three years' experience in financial planning, have a bachelor's degree and training in financial planning or a related field and be registered as an investment adviser with the Securities and Exchange Commission. NAPFA has continuing education requirements for its members, who are all fee-only advisers.

Many other professionals – attorneys, accountants, stockbrokers, bankers and insurance agents – also provide financial planning services. Note: Financial planners will often recommend creating legal documents, such as wills and trusts, but only licensed attorneys may draft such documents.

It’s wise to inquire how a financial planner will be compensated. Fee-only planners charge a set amount or hourly fees. Others are compensated from commissions on investments they recommend, or from a combination of fees and commissions. A national consumer magazine recommends using fee-only planners with a minimum of five years’ experience. It’s always helpful, of course, to seek out referrals from people you trust, especially those who have used the planner’s services.

PLEASE CALL OUR OFFICE

We hope this brief review of some of the possible methods of financial planning has been beneficial for you. If you would like assistance in planning a gift that can also benefit your financial planning, please call our office.

NOTES FOR TAX ADVISERS

1. Investment income in excess of $2,100 of children under the age of 19 (24 for full-time college students) is taxed using their parents' top rate. For these children, it may make sense to give them assets that defer income until their 24th birthdays.
2. I.R.C., §170. The maximum income tax deduction allowable for gifts of cash to charity is 60% of the donor's adjusted gross income. For gifts of most types of appreciated property, the limitation is 30% of adjusted gross income. Whichever limitation is applicable, amounts in excess of the limitation can be carried over up to five years. See I.R.C., §170(d)(1).
3. The highest rate currently is 37% within certain income ranges.
4. For taxpayers in the 12% and 10% tax brackets, long-term gains are tax free. I.R.C., §1411 imposes a 3.8% tax on net investment income.
5. I.R.C., §170(e). There are special rules and generally less attractive tax consequences if you give appreciated property that would give rise to ordinary income or a short-term capital gain if sold or if the gift is of tangible personal property.
6. I.R.C., §280A.
7. Medical expenses are deductible to the extent they exceed 7.5% of your adjusted gross income through 2018.
8. I.R.C., §213(d)(1)(B).
9. I.R.C., §404(a).
10. The contribution limit is $5,500 in 2018. Limits are indexed for inflation. Taxpayers ages 50 and older are permitted to contribute an additional $1,000.
11. I.R.C., §408A. First-time homebuyer expenses are exempt from penalty, as are disability payments.
12. Roth IRA rollovers are permitted without income limitation.
13. I.R.C., §1. For 2018 the tax applies to income over $2,100.
14. Legally, the tax is imposed on your right to transfer property at your death.
15. I.R.C., §2033 taxes all property to the extent of the interest of the decedent at the time of his or her death.
16. I.R.C., §2031.
17. I.R.C., §2042. Even if you have no ownership rights, proceeds payable to or for the benefit of your estate will be taxed.
18. The purpose of the estimate is to give you only a very general idea of your estate tax situation.
19. Property you have given away may still be taxable at your death, and any gift tax paid will be included if the gift was a gift of life insurance made within three years of death or you retained certain interests in the gift property or transferred such interests within three years of death [I.R.C., §2035].
20. I.R.C., §2053. See also I.R.C., §2054.
21. Taxable lifetime gifts made after 1976 are generally computed in determining estate tax liability[I.R.C., §2001].
22. The estate tax applies to estates in excess of $11.18 million (adjusted annually for inflation), with a top tax rate of 40%. Consult your tax adviser.
23. I.R.C., §2056.
24. I.R.C., §2055.

25. In most states, a trust can continue for any number of lives in being at the time of its creation, plus 21 years.

26. Generally trust property is taxed in the estate of a beneficiary other than the creator only if the beneficiary had a general power of appointment (i.e., a right to withdraw the property free of the trust or to dispose of it at death to persons of his or her own choosing, including his or her estate or creditors) [see I.R.C., §2041].

27. The impact of successive taxes is minimized by a credit allowable where a beneficiary dies within ten years after a decedent [I.R.C., §2013].

28. This calculation is based on a trust paid quarterly, using a 2% federal midterm rate. See Notice 89-60, 1989-1 C.B. 700.

The materials contained in this booklet are intended to show only some of the ways you can benefit our future and minimize your federal tax liability – with examples of anticipated federal tax liability. Thus, you should not take any action without first consulting your attorney.

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