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It is not that we plan to fail, it's just that we fail to plan.

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CANNON FINANCIAL INSTITUTE

Duane's Capital Ideas

Strengthening your financial future

Qualified Charitable Distributions Qualify for RMDs

If you're an IRA owner who must take a required minimum distribution (RMD) in 2011, you can avoid some or all of the resulting income tax liability by donating a portion of it to charity. A qualified charitable distribution (QCD), also known as an IRA charitable rollover, can not only save you income taxes, it can help minimize your taxable estate and fulfill your philanthropic desires. Through December 31, you can make tax-free transfers of up to $100,000 directly from your IRA to qualified charities. Here are the details.

Background

The QCD provision was enacted in 2006, and was scheduled to end in 2009, but last-minute legislation extended it into 2010 and 2011.

Prior to 2006, if a donor withdrew funds from a traditional IRA in order to contribute to charity, the withdrawal had to be reported as ordinary income and was taxed at regular income tax rates. Once the contribution was made, the donor was generally entitled to an income tax deduction for the value of the charitable contribution, calculated and reported on Schedule A of Form 1040 (subject to certain limitations), which could potentially offset some or all of the taxable income generated by the withdrawal.

With a QCD, you can exclude from taxable income any IRA funds directly transferred to a charity as an outright contribution.

Note: *There is currently legislation being considered in Congress that would make this provision permanent. It would also get rid of the $100,000 cap, reduce the minimum age at which taxpayers are able to take advantage of certain giving vehicles (e.g., charitable remainder trusts) from 70½ to 59½, and make it easier for donors to give through supporting organizations, private foundations, and donor-advised funds.*

Who might consider this strategy?

You would benefit most from implementing this strategy if you:

- Do not need all of the income from your RMDs
- Make charitable gifts, but don't itemize deductions (generally, only taxpayers who itemize get federal income tax-saving benefits from charitable donations)
- Make large charitable gifts, but are unable to deduct all of them in a given year because of adjusted gross income limitations
- Want to avoid being taxed on your RMDs

Certain limitations apply

Certain limitations apply to these nontaxable charitable distributions from an IRA:

- You must be at least 70½ years of age when the gift is transferred
- Total gifts cannot exceed $100,000 per year, per IRA owner or beneficiary (married taxpayers with separate IRAs can give up to $200,000 total per year, but no more than $100,000 may be distributed from each spouse's IRA)
- Gifts must be made directly from your IRA to a public charity (i.e., they cannot be made to a private foundation, a supporting organization, or a donor-advised fund)
- The gifts must be outright (i.e., they cannot be used to establish a charitable gift annuity or fund a charitable remainder trust)

Note: *Transfers must come from the IRAs directly to the charity. If you have retirement assets in a 401(k) or 403(b), for example, you must first roll those assets into an IRA, and then make the transfer from the IRA directly to the charity.*

Note: *You cannot do a QCD from a SEP-IRA or SIMPLE IRA.*

What are the income tax implications?

- Federal--You do not recognize the transfer as income, as long as it goes directly from the IRA to the charity. However, you are not eligible for an income tax charitable deduction.
- State--State laws vary, so check with your financial professional.

How Much Do You Know about Social Security?

For more information, visit the Social Security website at www.socialsecurity.gov or call 800-772-1213.

Social Security is in the news more and more, as the first wave of baby boomers retire and economic pressures on the program increase. More than 90% of Americans are covered by Social Security,* but how much do you know about this important program?

How is Social Security funded?

Unlike many government programs, Social Security is funded primarily through the collection of payroll taxes. In 2010, 81.9% of funding came from this source, with the rest derived from interest earned on government bonds held by Social Security trust funds and income taxes paid on benefits.* That's why Social Security is known as a "pay-as-you-go" system. However, someone working and paying Social Security taxes today is not funding his or her own benefits, but is funding the benefits of someone who is receiving them now or in the near future--one of the reasons why Social Security is facing a potential funding shortfall. According to the Social Security Administration (SSA), the number of retired workers will double in less than 30 years, but there will be fewer workers paying into the system. And with life expectancies increasing, benefits will be paid for a longer period.*

How are earnings reported to the SSA?

If you work for an employer, your employer will send a copy of your W-2 form annually to the SSA. If you're self-employed, the IRS will report your earnings to the SSA annually after your federal income tax return has been processed.

What benefits are available?

Although Social Security is known as a retirement program, benefits are paid to people of all ages, including surviving family members and disabled individuals. In 2010, 5.7 million people were awarded Social Security benefits. Of those, 46% were retired workers, 36% were survivors or spouses/children of retired or disabled workers, and 18% were disabled workers.*

How do you qualify for benefits?

As you work and pay payroll taxes, you earn Social Security credits. Generally, you need to work 10 years to earn enough credits to qualify for retirement benefits--other benefits have different requirements. Contact the SSA if you have any questions about your benefit entitlement.

Do most people apply for early retirement benefits?

Yes. According to a report by the Government Accounting Office (GAO), 43% of people take early retirement benefits at age 62, while almost 73% of people apply for benefits before they reach full retirement age.**

How much more will you receive if you delay applying for benefits?

For each year past your full retirement age you delay receiving benefits, your Social Security benefit will increase by a certain percentage (8% for anyone who was born in 1943 or later). For example, if your full retirement age is 66 and you delay receiving benefits until age 70, your annual benefit will be 32% higher.

Can you receive benefits based on an ex-spouse's record?

You may qualify for divorced spousal benefits if you were married for at least 10 years, you haven't remarried, you are age 62 or older, and you don't qualify for a higher benefit based on your own work record.

Do workers with lower earnings receive more from Social Security?

A worker who has lower earnings will receive a lower monthly benefit than someone with higher earnings because benefits are based on average lifetime earnings (the highest 35 years of earnings are used in the calculation). However, the Social Security benefit formula is designed to ensure that workers with lower earnings receive a greater percentage of their preretirement earnings. For example, a worker with relatively low earnings may receive a benefit that is approximately 55% of his or her preretirement earnings, while a worker with relatively high earnings may receive a benefit that is approximately 25% of his or her earnings.***

Do you have to stop working to receive Social Security retirement benefits?

No. As long as you've reached early retirement age and meet eligibility requirements, you can apply for Social Security benefits even if you decide to continue working. However, if you're younger than full retirement age and earn more than a certain amount, your benefits will be temporarily reduced (once you reach full retirement age, your benefits will be increased to account for the money that was withheld).

***Source:** *Fast Facts & Figures About Social Security, 2011*

****Source:** *GAO-11-400, Retirement Income, June 2011, based on data compiled by the SSA Office of the Chief Actuary*

*****Source:** *SSA Publication No. 05-10045, 2011*

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Gift Tax Strategies

Now may be a great time to make gifts that take advantage of the current large gift tax applicable exclusion amount, low gift tax rates, depressed property values, and low interest rates.

The current large gift tax applicable exclusion amount, low gift tax rates, depressed property values, and low interest rates create a favorable environment for making certain gifts.

Federal gift tax basics

Annual exclusion. Each year, you can give a certain amount ($13,000 in 2011 and 2012) to as many individuals as you like gift tax free.

Qualified transfers exclusion. You can give an unlimited amount on behalf of any individuals for tuition or medical expenses gift tax free. You must pay the amount directly to the educational or medical care provider.

Applicable exclusion amount. Gifts can also be sheltered by the applicable exclusion amount, which can protect gifts of up to $5,120,000 (in 2012; $5,000,000 in 2011). The dollar limit applies to all taxable gifts you make during life and to your estate at your death for federal estate tax purposes.

Basic planning

The first gifts you consider should generally be annual exclusion and qualified transfer gifts. You can make annual exclusion gifts to anyone for any purpose. The annual exclusion is lost in any year in which you do not use it. You can make unlimited gifts using the exclusion for qualified transfers, but gifts are limited to educational and medical purposes.

You and your spouse can split gifts that either of you make. Doing so allows you and your spouse to effectively use each other's annual exclusions and applicable exclusion amounts. For example, if you have 2 children, you and your spouse could make annual exclusion gifts totaling $52,000 to your children (2 spouses x 2 children x $13,000). If you make gifts of $52,000 for 10 years, you will have transferred $520,000 to your children gift tax free.

Next, consider gifts that are sheltered by the applicable exclusion amount. But remember that use of the applicable exclusion amount during life reduces the amount available for estate tax purposes at your death.

If you are likely to have a very large taxable estate at your death that could not be sheltered by the applicable exclusion amount, it might even make sense to make gifts that cause you to pay gift tax. For example, let's assume any additional transfer you make would be subject to the current top gift or estate tax rate of 35% and you make a taxable gift of $1 million to your child on which you pay $350,000 of gift tax. If instead you retained the $1,350,000 until death, $472,500 of estate tax would be due ($1,350,000 x 35%) and only $877,500 of the $1,350,000 would remain for your child. By making the taxable gift and paying gift taxes that reduced your taxable estate, you reduced taxes by $122,500 while increasing the amount transferred to your child by the same $122,500.

Gift considerations

If you have property whose value is depressed, now may be a good time to make a gift of it. The gift tax value of a gift is its fair market value, and a lower value means a smaller gift for gift tax purposes. However, you generally should not make gifts of property that would produce an income tax loss if sold (basis in excess of sales price). The person receiving the property would have a carryover basis and would not be able to claim the loss. In these cases, instead consider selling the property, claiming the loss, and making a gift of the sales proceeds.

Future appreciation on gifted property is removed from your gross estate for federal estate tax purposes. However, while property included in your estate generally receives a basis stepped up (or stepped down) to fair market value when you die, lifetime gifts do not. Therefore, you may wish to balance the gift tax advantage of a gift with carryover basis and income tax on gain if the property is sold against the income tax advantage of a stepped-up basis and estate tax (if any) if you retain the property until your death.

In the current low interest rate environment, you may wish to consider a grantor retained annuity trust (GRAT). In a GRAT, you transfer property to a trust, but retain a right to annuity payments for a term of years. After the trust term ends, the remaining trust property passes to your beneficiaries, such as family members. The value of the gift of a remainder interest is discounted for gift tax purposes to reflect that it will be received in the future. Also, if you survive the trust term, the trust property is not included in your gross estate for estate tax purposes. Any appreciation in the trust property that is greater than the IRS interest rate used to value the gift escapes gift and estate taxation. The lower the IRS interest rate, the more effective this technique generally is.

In the current low interest rate environment, you may also wish to consider a low-interest loan to family members. You are generally required to provide for adequate interest on the loan, or interest will be deemed for gift tax purposes. However, with the current low interest rates, you can provide loans at a very low rate and family members can effectively keep any earnings in excess of the interest they are required to pay you.

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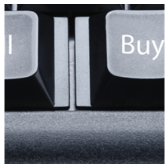


Will my broker calculate my cost basis for DRP stocks?

If you think you don't need to track cost basis on your own because brokers must now report to both you and the IRS the cost basis for any stock sold, there are some potential pitfalls to be aware of.

First, new cost basis reporting requirements are being phased in. New regulations requiring brokers to report cost basis generally apply only to stocks bought after January 1, 2011. (Mutual funds will become subject to the same provisions in 2012; bonds and options will follow in 2013.) However, for a stock bought as part of a dividend reinvestment plan, or DRP, the new provisions will apply only to purchases made on or after January 1, 2012. As a result, for most DRP stock purchased before that date, in most cases you or your tax preparer will still be responsible for calculating accurate cost basis information.*

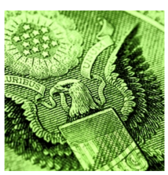
Because DRPs typically involve many purchases over a long time, calculating the cost basis for a DRP stock could be challenging. Fortunately, there's also a provision that makes the calculation easier. For stocks held in DRPs, the cost basis of all purchases in the plan can be averaged to determine the cost basis for individual shares sold.

The ability to average sales from a DRP applies only to plans whose documents specify that at least 10% of every dividend paid must be reinvested in identical stock. To be considered identical, the stock must have the same CUSIP number, which would not apply to purchases of the same stock made outside the DRP.

Even after adjusted cost basis reporting is available for DRP stocks, you can still specify which shares are considered the ones sold for tax purposes. However, you must do so before the trade settles--typically, three days after the transaction.

You can include any transaction costs paid as part of your adjusted cost basis. And even though your adjusted cost basis may be calculated by someone else, it may still be a good idea to keep documentation of any purchases or sales to make sure it matches the information being supplied to the IRS.

Note: *The reporting regulations already apply for DRPs that do not require reinvestment of at least 10% of every dividend paid.*



Are there exceptions to new cost basis reporting rules?

New provisions that went into effect in 2011, requiring brokers to track and report adjusted cost basis for stocks, have special provisions that apply in certain situations.

Wash sales: A wash sale occurs when a substantially identical security is purchased within 30 days before or after the security it replaces is sold; when that happens, any losses resulting from the sale are not immediately deductible for tax purposes. The new regulations still require taxpayers to comply with the IRS regulations governing wash sales. However, brokers are required to adjust the cost basis of a wash sale only if the newly acquired securities are identical to the securities sold (meaning the securities involved share the same CUSIP identification number).

Brokers also are not required to report adjusted cost basis for wash sales when the purchase and sale transactions occur in different accounts. However, taxpayers are still responsible for accurately reporting the proceeds of any wash sale transactions, regardless of whether the purchase and sale are made in the same account.

Short sales: In the past, the IRS required brokers to report a short sale for the year in which the short position was opened; however, the proceeds of a short sale generally were taxed in the year in which it was closed. The new regulations correct that discrepancy. In addition to requiring brokers to track cost basis, the new regulations mandate that the cost basis of a short sale will now be reported in the year in which the short is closed. For example, if you initiated a short position in July 2011 that was closed two months later, the cost basis should appear on the 1099-B form for 2011 that brokers must submit to the IRS in early 2012. However, if the position has not been closed before January 1, 2012, the cost basis will be reported to the IRS only after the position is closed. If you close the position after January 1, 2012, it would appear on the 1099-B due in early 2013.

Even though brokers must now supply additional information about the net proceeds of a stock sale, it's worth remembering that the individual taxpayer is still responsible for accurately reporting information to the IRS.

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