Flash!
News from the Pomona Plan
A Financial Guide for Friends and Alumni of Pomona College (800) 761-9899
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The Future of the Federal Estate Tax May Be Uncertain, but Your Future Can Be Planned

It has often been said that nothing is certain except death and taxes. Ironically, though, in this environment of legislative impasse that grips the country, one of the most uncertain issues facing Americans as they plan their estates is the federal estate tax.

When it comes to following changes in the federal estate tax, it is easy to feel like you are shooting at a moving target. Most recently, Congress greatly increased the amount a taxpayer could pass free of tax to $5,120,000, but it made the law effective only through the end of 2012. At that time, Congress could choose to extend that exemption, create a new one or simply let the law expire. If the law expired, it would cause the exemption to revert to the law in effect in 2001, with a much smaller $1,000,000 exemption and a higher top tax rate that would jump from 35% to 55%.

"It's a little less amusing when you hear your kids calling it 'the death tax.'"

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Some believe that the most likely outcome is the extension of an exemption similar to the amount currently in effect. The good news is that at these levels, fewer than 1% of Americans would have to pay any federal estate tax at all. Of course, it pays to be vigilant because there are no guarantees about what will happen when the current law expires.

Perhaps the most important lesson in this for most of us is that good estate planning involves much more than planning for federal estate taxes. It really is about organizing your affairs to address the values and objectives most important to you on the basis of your unique circumstances.

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Larger Estate? How to Deal with Federal Estate Tax and How Charitable Planning Can Help

If your estate is in the range affected by federal estate tax, extra care should be exercised in tax planning. Congress currently allows each individual to pass on $5,120,000 free of tax, with any amount above that generally subject to estate tax. The good news is that Congress offers some opportunities that benefit married couples and philanthropic individuals. For married couples, each taxpayer may give his or her spouse an unlimited amount of assets without tax consequences. In addition, current law also allows the first spouse to die to transfer any unused exemption balance to the surviving spouse, effectively increasing the surviving spouse's exemption.

Those with philanthropic objectives can also reduce their federal estate.

While this "marital portability" of the estate tax exemption is not available to single persons, any individual with philanthropic objectives, married or not, can reduce his or her federal estate by making provisions for charitable organizations.

Example: Christopher B is a strong supporter of Pomona College and expects his estate to be in excess of $10,000,000 at his death. His will directs that an amount equal to the federal estate tax exemption in effect at the time of his death, currently $5,120,000, be divided between his two children, Collin and Melanie. It further directs that we receive 25% of the excess, with the other 75% passing to his wife Cynthia if she survives him.

Here, no federal estate tax is due at Christopher's death. His provisions for his children are covered by the federal estate tax exemption, the provision for Pomona College qualifies for an estate tax charitable deduction and the provision for Cynthia qualifies for the unlimited estate tax marital deduction.

As mentioned previously, under current law effective until December 31, 2012, each taxpayer may pass up to $5,120,000 free of federal estate tax. Thus, a married couple can pass $10,240,000 tax-free. But what if the first spouse to die has assets valued at $3,000,000 and the surviving spouse has assets valued at $7,240,000? It would seem that there would be $2,120,000, the amount in excess of the survivor's $5,120,000 exemption, that would be subject to a 35% tax. However, under the new portability provision introduced late in 2010, the unused $2,120,000 exemption of the first spouse may be added to the surviving spouse's $5,120,000 exemption, bringing the total exemption up to $7,240,000 and nullifying the estate tax on the entire combined $10,240,000 estate.

"Welcome aboard. You are now exempt from federal, state, and local taxes."

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Smaller Estate but Still Want to Express Your Generosity? How to Benefit from Tax Savings—You Are Not Subject to Federal Estate Tax

The majority of taxpayers will never have to deal with the federal estate tax if exemption levels remain at or close to where they are currently. That does not mean, though, that those with charitable objectives are without options for realizing tax savings from their charitable giving.

INCOME TAX SAVINGS. Many philanthropically-minded people are finding that even though charitable estate provisions will generate no estate tax savings, they may be able to realize income tax savings by accelerating their charitable gifts during their lifetimes. For those in a position to make gifts currently, the savings can be significant.

The majority of taxpayers will never have to deal with the federal estate tax …

Example: Jean R, 78, decided several years ago that she would like Pomona College to have her home at her death. She and her late husband William built the home more than 30 years ago, and it is now debt-free and valued at $450,000. The value of her total estate is approximately $2,500,000.

Jean is delighted to learn that she can make a gift now that gives Pomona College her home and allows her to remain in that home for the rest of her life. Because she makes the gift now, she is entitled to an income tax deduction of almost $340,000, which saves her more than $111,000 in taxes in her 33% federal income tax bracket. These tax savings increase the assets she has available for other intended beneficiaries, including charity.

This plan, referred to as a retained life estate, is particularly attractive because it does not diminish liquid assets Jean may need for other purposes.

Do I Need an Estate Plan?

By Marlo Cookston Davis

Q: I am not sure I need an estate plan—I have always thought they were only for wealthy people with a lot of money to pass on. Why should I consider making an estate plan?

A: One major misconception regarding estate planning is that such plans are limited to the wealthy. In actuality, the need for estate planning applies to everyone. A smaller estate requires even more care to avoid unnecessary expenses. A well-crafted estate plan helps ensure the fulfillment of your personal, financial and philanthropic goals.

Benefits of establishing an estate plan:

- **Defining care for yourself—**A health-care proxy, power of attorney and living will define how you wish to be cared for should you ever experience a period of incapacity.
- **Creating financial security—**A will allows you to dictate how you want your money distributed and to whom, regardless of the amount. If you do not have a will, state laws will determine who receives your assets.
- **Naming guardians—**If you have children or beloved pets, it is important to make written arrangements for their care. A will is the only legally recognized way to name a person you would like to entrust with the care of your children or pets.
- **Naming beneficiaries—**Fill out beneficiary forms for assets such as insurance policies and retirement accounts. Review your designated beneficiaries after major life events. You can also name a charitable organization as a primary beneficiary, cobeneficiary or contingent beneficiary.

Because no two situations are alike, the best course of action is to have your financial advisor and attorney review the specifics of your estate plan.

Increase Cash Flow with Life-Income Gifts

Some charitably inclined individuals are more concerned about the annual cash flow generated by their assets than by the ability to directly access those assets.

These charitable plans are particularly attractive in this climate of near-record-low returns on traditional investments. The return on a ten-year treasury note has hovered near or below 2% for several months. Rates on most certificates of deposit (CDs) are even lower. Many charitable options can generate significantly more annual spendable cash while providing a charitable income tax deduction.

Example: Martin T, aged 75, is a longtime supporter of Pomona College. He intends to give us 20% of his estate at his death and expects it to total about $500,000. Substantial portions of Martin's assets are liquid, and he foresees no major capital expenditures over the balance of his lifetime. When Martin learns that the renewal rate of $500,000 worth of CDs coming due soon will be only 1.5%, he decides to look into a charitable gift annuity with Pomona College.

He is pleased to learn that a gift annuity in that amount will pay him $43,000 each year for the rest of his life—far better than the $7,500 the CD would have generated. Even better, he discovers that more than $34,000 each year will be tax-free for the rest of his life expectancy. In addition, Martin is entitled to an income tax deduction of more than $74,400, saving him in excess of $30,500.

FROM THE DIRECTOR:

Converting Your IRA to a Roth and Struggling with Extra Taxes? Offset with a Gift to Pomona—Problem Solved!

Richard C '64 has wanted to take advantage of a Roth IRA for some time, but his income level has disqualified him from making direct contributions to a Roth. Now, under new rules permitting conversions from traditional IRAs to Roth IRAs, Richard is looking at converting an existing IRA holding $125,000 in savings. The only problem is that the conversion will elevate his adjusted gross income (AGI) from $175,000 for the year to $300,000 when he reports the conversion on his 2012 tax forms. This change will subject him to a 33% tax bracket on this higher income amount, resulting in $41,250 in additional tax liability, which is a steep price to pay for the conversion!

Remembering that the *Flash!* newsletter has touched on tax and gift planning in the past, Richard called Pomona's Office of Trusts and Estates for advice on strategic approaches to giving that might help offset the tax burden. We learn from Richard that, in addition to this potential tax burden, he has been contemplating an increase in his annual-fund contributions as his way of supporting *Campaign Pomona: Daring Minds*. His thought was to give $10,000 a year, for a total of $50,000, as a pledge to the campaign. While he has the entire amount of the gift in savings, he was planning to spread the contribution out over five tax years. However, by paying the entire sum in 2012 he could create a charitable deduction that would reduce his AGI to $250,000 and his tax liability to $24,752, which would be a savings of $16,498. *Problem solved!*

Roth IRA conversions provide an opportunity to create a strong, tax-free stream of retirement income. But tax strategies such as Roth conversions can be difficult to navigate. Professional gift planners, such as the staff in the Trusts and Estates office, can be helpful guides through these complexities.

If you would like help in planning a gift to Pomona that will also benefit you, please give us a call. We will be happy to help.

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