Flash! News from the Pomona Plan

A Financial Guide for Friends and Alumni of Pomona College (800) 761-9899

Summer 2011

3 Powerful Strategies for Your Financial and Estate Plans

1. Bump Up Your Returns

When setting financial and estate-planning goals, many people currently face an investment conundrum. On one hand, they are uneasy about where the stock market is headed. On the other hand, the returns on traditional income-producing investments such as bonds, money-market funds and certificates of deposit are at near-record lows.

Money-market funds pay barely a fraction of 1%, and only longer-term CDs generate more than 2%. The returns on bonds have also slipped substantially and carry an additional risk: if interest rates do rise, the principal value of bonds melts away. All this leaves many feeling that they have no choices for safe, meaningful returns.

"Just so you know, I'm taking all this with me into the afterlife."

Those with significant charitable objectives have options not available to others—options that are more attractive than ever. A number of creative giving plans return an attractive stream of income to donors.

Example: Jeff T, 70, counts on his investments to provide a meaningful portion of his retirement income. In the last few years he has seen that income steadily decline. He is concerned about the preservation of his principal if he invests in stocks, but he gets more discouraged as each maturing CD is renewable for substantially less than what it was paying.

Jeff is a longtime supporter of Pomona and has always wanted to find a way to make a substantial contribution to our work. Accordingly, when a $200,000 CD recently came due for renewal at 1.5%, Jeff decided to transfer those funds to us in exchange for a charitable gift annuity that will pay him 7.8% ($15,600) each year for the rest of his life. His gift entitles him to a charitable income tax deduction of slightly more than $28,000.

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In his 33% federal income tax bracket, the deduction saves Jeff about $9,200, reducing his out-of-pocket cost for the gift annuity to about $190,800. Even better, $10,810 of his annual annuity income will be tax-free for the balance of his life expectancy, effectively making the value of his annuity equal to a fully taxable return of around 10.5% from a traditional income-producing investment.

2. Provide for Loved Ones and Pomona

Historic low interest rates present other creative estate-planning opportunities for those looking to address personal and charitable goals simultaneously. And with good planning, you can minimize the impact of the federal gift tax and any future changes in the federal estate tax law.

Because of the way charitable deductions are calculated, for income tax as well as estate and gift taxes, the prevailing interest rate has a substantial impact on the amount of those deductions. Moreover, a low rate can cause some deductions to increase and others to decrease, depending on the type of gift plan involved.

Low interest rates create opportunities for donors to pass significant assets to family members, with dramatic savings in federal gift tax and/or estate tax. Taxpayers are realizing unprecedented savings by giving charities a stream of income from assets that will eventually be distributed to family members.

Example: Ann H, 62, wants to fund a major project at Pomona but does want her children to receive the bulk of her estate eventually. To accomplish these goals, Ann places $2 million in a charitable lead trust that will pay Pomona $100,000 per year for 20 years, at which time it will be divided equally between her son Mark and daughter Susan, currently 34 and 32.

Because her assets will ultimately go to her children, Ann's transfer to the trust is subject to federal gift tax. But because of current low interest rates, only $512,260 counts as a taxable gift, well below Ann's gift tax exemption amount.

If the trust is able to achieve an annual total return of 8%, it will grow to around $4.7 million. By using this powerful planning tool, regardless of what happens with the federal estate tax, neither Ann nor her estate would ever owe tax on any of the appreciation.

3. Satisfy Charitable and Retirement Goals

While many Americans are unsure about where the economy is headed in the short run, most are confident about the long-term. As you look toward the future, plan your estate to meet both your charitable and retirement goals.

Many taxpayers in their peak earning years wish they could find more tax-advantaged ways to set aside money for retirement. To the extent that retirement-planning opportunities are available to you through your employment or through options open to most Americans, you will want to take full advantage of those. If you would like to accumulate still more and you also have major charitable goals, there are creative options for reaching your objectives. A charitable remainder trust is one such option. This trust is not just helpful for retirement planning; it is also an important estate-planning tool.

Example: Karen B, 50, has a very successful consulting practice. She makes the maximum allowable contributions to all retirement plans open to her but is concerned that it may not be enough to allow her to enjoy the kind of retirement she envisions.

Karen is a major supporter of Pomona and would very much like to complete a substantial gift to complement the contribution she makes annually. After conferring with her advisors and a member of our staff, Karen decides to put a plan in place that will meet her personal and charitable objectives: she contributes $100,000 to a charitable remainder trust designed to supplement her retirement income.

The trust will pay her 6% of its annual value each year; but until she turns 65, it will make the payments out of the trust's income. Since Karen really doesn't need, or want, additional income right now, the trust is invested in a manner that focuses on growth rather than income over the next 15 years, and she will receive little or no distributions during this time frame. She will start getting income when she reaches her anticipated retirement age of 65.

Assuming the trust generates an 8% total return annually, it will have grown to about $293,000 at that point. Karen will receive more than $17,000 her first year of retirement, and more than $400,000 over her life expectancy. Pomona will ultimately receive more than $427,000.

Choosing the Right Executor for Your Estate

When selecting someone to administer your will, there are many factors to consider. Some people choose a family member or close friend as their executor. Others choose a professional or nonprofit organization. Still others use a specialist such as an attorney or accountant.

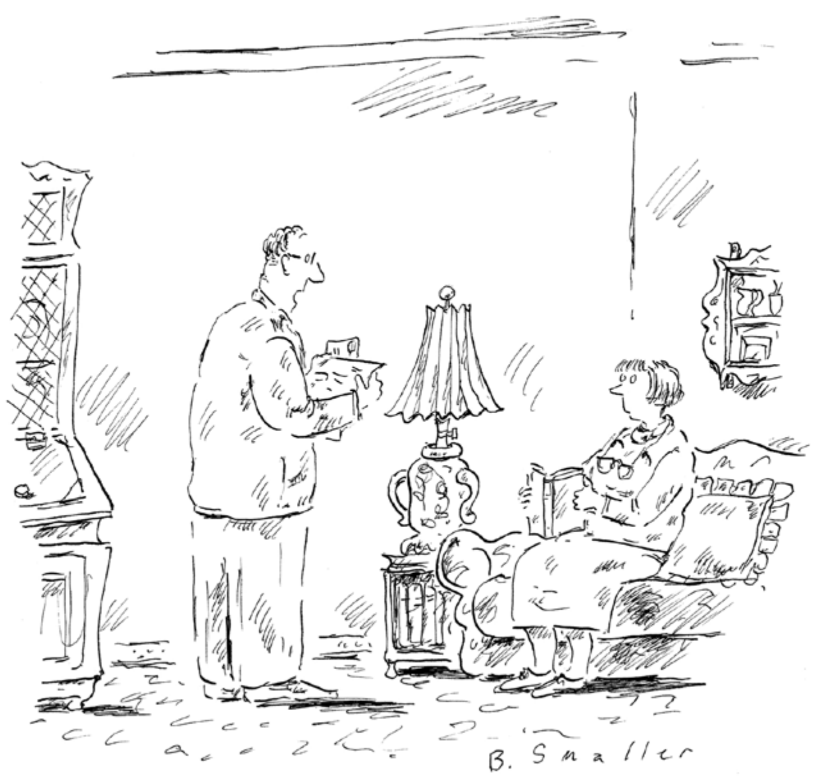
An executor ensures your intentions toward charitable organizations will be honored.

In choosing the right executor, keep in mind the complexities of your estate and the abilities of that person. You can inventory family and friends to assess their skills. If family and friends cannot properly carry out the executor functions, you can opt to obtain the services of a professional. The executor will:

- **Assemble and inventory the assets in your estate.** This task includes making a list of all bank, brokerage and retirement accounts; any property you owned; and an inventory of personal effects for the probate court to review.
- **Arrange for the necessary appraisals of your property.**
- **Protect and manage estate assets.** Managing assets can include making important investment decisions.
- **Notify estate creditors and handle claims against your estate.** Failure to make proper notification of your death and creditors' right to make a claim against the estate can result in lawsuits.
- **Find out the family's immediate cash needs and make sure that funds are available as needed.**
- **File tax returns and pay taxes.** Any refunds will pass to beneficiaries.
- **Distribute your estate—especially the charitable gifts.** The executor ensures that your intentions to help a favored charitable organization will be honored.

In your will, you can give to charity through:

- **An outright bequest.**
- **A charitable remainder trust,** which provides income for your loved ones, with the remaining assets eventually benefiting a charitable organization. This generates significant income and estate tax deductions.
- **A charitable lead trust,** with the charitable organization receiving the use of assets for a specified period of time before they revert to other people such as your children or grandchildren. This reduces estate tax liabilities on your loved ones.



"My pension has been renegotiated, and in lieu of a monthly check I'll receive a crateful of seasonal fruit."

Tips on Handling an Inheritance

Seventy percent of baby-boomer households will receive inheritances, according to the Center for Retirement Research at Boston College. Here are three pointers for handling an inheritance.

Feed Your Retirement Accounts If you're working and not contributing the maximum allowed to retirement accounts, consider using some of your inheritance for living expenses and diverting more of your earnings into tax-favored retirement accounts. Most private employees age 50 and older can contribute a maximum of $22,000 a year to a 401(k) and $6,000 to an IRA or Roth IRA.

Stretch Out That IRA You can stretch out withdrawals and tax benefits if you inherit an individual retirement account from a parent and handle it properly. Rules prohibit taking the money out and putting it in your own IRA. Instead, your parent's IRA should be renamed, "John Smith, deceased, inherited IRA for the benefit of John Smith, Jr." If several people are named as beneficiaries, ask the custodian to split it into separate inherited IRAs. ***Note:*** Withdrawals from a traditional IRA will be subject to income tax; those from a Roth are tax free.

Consider a Charitable Gift as a Means of Managing Your Inheritance You might consider using your inheritance to set up a charitable remainder trust that will provide your heirs with periodic payments as long as they live. When they die, the remaining assets in the trust (the "remainder") will benefit a nonprofit organization whose cause you believe in.

FROM THE DIRECTOR:

Save Taxes for Your Heirs by Using Your IRA to Fund Your Testamentary Gift—Problem Solved!

Mary '62 and John '62 Fuller met at Pomona College and were married in Little Bridges. John became an attorney and Mary a veterinarian. They both built strong practices and now have a combined net worth of $3.9 million.

As their 50th reunion and anniversary approach, Mary and John want to update their estate plan to make a significant testamentary gift to the college that fostered their happy marriage and successful careers. They're thinking they'll amend their family trust to leave $250,000 to Pomona and the rest to their heirs.

Mary and John contact the Trusts & Estates Office to discuss their plans. We learn that they hold almost $2.1 million in their IRAs, with everything else in their family trust. We explain that if they make their charitable gift through the family trust, they will miss an opportunity to save significant income (and potentially estate) taxes for their heirs. If their heirs take a $250,000 distribution from an IRA, income taxes will be due. At today's highest federal marginal rate of 35%, those taxes would be $87,500. This problem could be avoided by naming Pomona as a partial beneficiary of their IRAs. The heirs could then receive $250,000 from the trust without income tax cost. *Problem solved!*

IRAs and qualified retirement plans make *excellent* sources for testamentary gifts to Pomona because they are subject to both income and estate taxes if left to individuals. Leaving them to charity eliminates the tax burden. To achieve these results, the gift must be made through a beneficiary designation with the plan administrator and NOT through a specific bequest in a will or trust.

If you'd like help in finding tax efficiencies in structuring a gift to Pomona College, please give us a call. We'll be happy to work with you and your attorney to achieve your charitable and estate objectives.

Robin Trozpek

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