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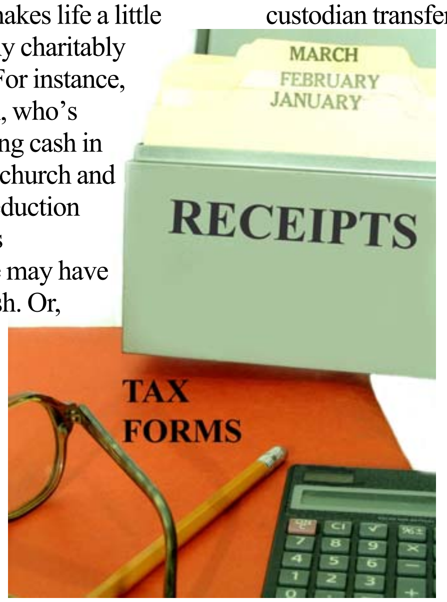
Charitable Giving Rules Changed By New Tax Act

Supporting charities just got more complicated. Beginning in 2007, all cash donations, no matter how small, must be documented by a bank record or a written communication from the charity providing its name, the date, and the amount you gave.

This new dictate is one of many provisions dealing with philanthropy in the Pension Protection Act of 2006. (Charitable reform happens to be a key ingredient in this sweeping retirement savings law.) And it makes life a little more difficult for many charitably inclined individuals. For instance, take the case of Helen, who's accustomed to dropping cash in the collection plate at church and then claiming a tax deduction based on what she has contributed. Now, she may have to use a check, not cash. Or, because she is older than 70½ and has money in a traditional IRA, there is another option. Normally, IRA owners who've passed that age must take annual, taxable withdrawals. But for 2006 and 2007 only, the pension act authorizes "qualified charitable distributions" of up to $100,000 that can go straight from an IRA to charity. Such distributions count toward your required withdrawals. Yet because they're charitable contributions, they aren't taxed. And because such a distribution wouldn't be included in Helen's income, it could ease the tax bite on her Social Security benefits, too. Under the old rules, a taxpayer such as Helen, who doesn't itemize deductions, got no break for gifts.



Yet itemizers can benefit, too. Dave and Clara routinely deduct medical and miscellaneous itemized expenses, but because their income exceeds IRS thresholds, the value of those deductions is reduced. Giving directly from their IRAs keeps their earnings down and enlarges their deductions. Dave and Clara may give $100,000 apiece.

Contributions must go directly from the IRA to the charity, with the account custodian transferring the money at the owner's request. But the IRA can't be a SEP or SIMPLE, and the money can't go to a donor-advised fund or private foundation.

Another rule change affects individuals who rummage through their homes periodically looking for items to give away. The pension act says that to deduct donations of used clothing and household goods, the items now must be in at least "good condition" and have more than "minimal value"—inexact terms the law left undefined.

What is clear is that taxpayers claim $9 billion annually for such contributions, and Congress wants to make sure donated items have bonafide uses. This rule went into effect on August 18, 2006, the day after President Bush signed the pension law, so the couple's 2006 tax return could be affected. Used items worth more than $500 need not be in "good" condition if

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Get Your Tickets! There's a New Act In Town

As much of the recent Pension Protection Act of 2006 revolves around employers shoring up their pension plans, it also addresses other areas including the world of charitable giving. This timely article (to the left) explains the window of opportunity that is open for 2007. Being "in the know" about the special rules on charitable giving from IRAs could provide great benefits.

Great benefits can come in many shapes and sizes. Frequent-flyer programs have gained considerable attention over the last several years while airlines try to reel in the travelers. Have you, or someone you know, signed up for the airline-of-your-choice's frequent flyer program – only to find out you really don't know when, where, or how it works? There's help out there. Read about resources that help you maximize your miles and find the best deals offered!

Now, for those of you who are in or near retirement, you have the dilemma of deciding where to live. Some are looking for better climates, others want to be near the grandchildren and still others are searching for the best place to pursue their favorite hobbies. Avoiding five common mistakes could make this transition a bit easier. Additionally, what happens to your home when you can no longer live there? There are several steps that can be taken now to make sure your heirs make good decisions. We hope you enjoy the articles surrounding these topics.

Jim Joseph
Client Relations Manager

A Skeptical View Of Variable Annuities

Variable annuities (VAs) soared from obscurity a decade ago to have $1.3 trillion in total assets in late 2006, according to the National Association for Variable Annuities. However, many skeptics say VAs are popular not because they're great for investors, but because they're usually great for the people selling them. VAs are often laden with punishing fees that can drain the value of your account.

VAs are not all bad. Indeed, some individuals can benefit from a VA. It provides tax-deferral for investments, just as a 401(k) or IRA does. Unlike an IRA, there's no limit on contributions and no mandatory withdrawals. You can put your money in a wide range of professionally managed subaccounts, very much like mutual funds. And if you happen to lose money and die while the account is down, your beneficiaries could receive a death benefit. In addition, many VAs offer a "living benefit" rider that promises minimum lifetime income regardless of investment performance. With all these benefits, VAs make for a great sales pitch, and that makes it especially important to be aware of the drawbacks.

Bells and whistles can make a VA seem complicated, but the basic structure is simple. An insurance component provides a benefit upon your death and allows a VA its tax-deferred status under U.S. tax law. You decide how you want your account invested, dividing money among a menu of mutual fund-like subaccounts. Like other tax-deferred accounts, VAs permit penalty-free withdrawals after age 59½. Before that, there's a 10% tax penalty on your policy earnings. All withdrawals of earnings, whenever they're made, are taxed as regular income.

The biggest problem with VAs is that fees tend to be extremely high. They impose insurance and administrative expenses on top of management fees for the subaccounts. Fees can be in excess of 2% of your assets annually. There may also be annual contract charges and sales loads on investment subaccounts.

Meanwhile, the death benefit isn't likely to be much. There are scenarios in which it would be valuable—for example, if you died shortly after making a large investment and the market had dropped sharply. But that just doesn't happen very often. According to LIMRA International, an insurance research group, only three of every 1,000 VA contracts are surrendered because of death or disability.

Taxes are another shortcoming. When money comes out, it is taxed as income at rates of up to 35%. Compare that with the top rate of 15% on most long-term capital gains and qualified dividends in taxable accounts. Several states also impose additional taxes on VAs. And while the tax advantage for mutual funds may be partially offset by tax-deferred compounding within a VA, it could take many years of tax-deferral for a VA to come out ahead.

There's also the tax treatment of inherited VAs. Heirs, like any other account owner, are subject to tax at income rates on withdrawals. In contrast, the tax basis of an inherited mutual fund is stepped up to its value when it passes to your heirs, so that gains you earned during your lifetime aren't taxed at all.

The final indignity? If you experience buyer's remorse after purchasing a VA, you'll probably have to pay a surrender charge of as much as 7% to get your money back. While VAs may be right in some circumstances, we are here to serve as your trusted advisor in evaluating such sales pitches. ●

When Parents Are No Longer Able To Live Independently,

Brace yourself. When your parents die, you may find yourself regressing, feeling once again like a helpless child—an orphan!—just when you and your equally stressed siblings face the emotionally wrenching task of divvying up your parents' personal belongings and letting go of the family home.

Pity the poor children whose parents named them all as equal beneficiaries. Sure, it seems fair, and that's what your parents intended, for each of you to get no more nor less than your brothers or sisters. But working out the details all too often brings long-buried childhood grievances and sibling rivalries back into the open.

To avoid painful clashes, begin a conversation now with your parents and your siblings, when decisions can be made without the added trauma of a parent's death. Here are ways to minimize family drama.

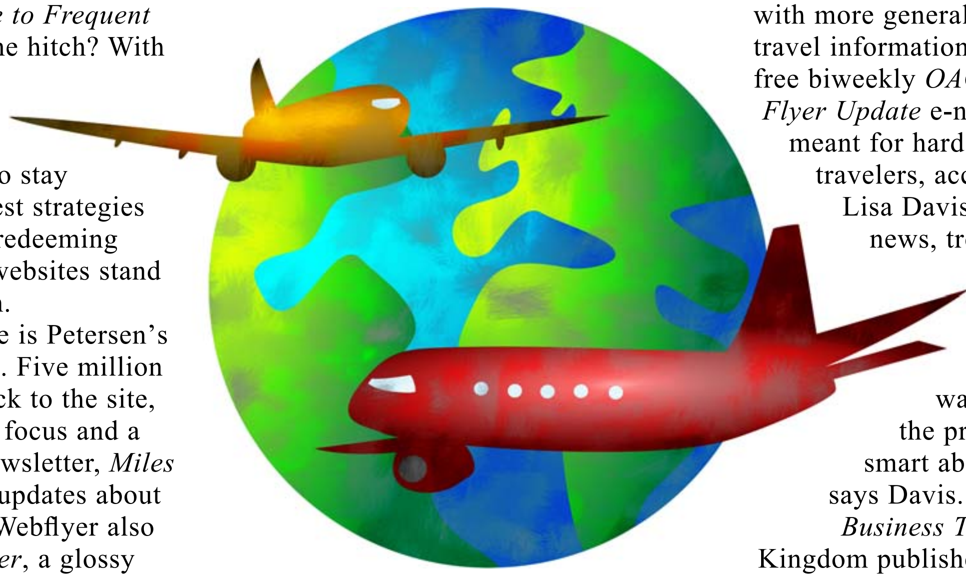
1. **Pick a leader.** There are countless details to handle and decisions to be made either after a death or when your parents are no longer able to make their own choices. Even if your parents have already named someone outside the family to serve as executor for their estate, choose a sibling to be point-person and manage the process alongside the executor.
2. **Remember, the family home is more than a piece of real estate.** Many families focus on the house, but often it's the contents that hold the most value for children—and the most potential for hurt feelings. Talk among yourselves about who wants your grandmother's china or the piano, and then put a plan together that incorporates these heirlooms into a roughly equal distribution of assets.
3. **Don't be shy. If you want the**

Finding The Best Frequent Flyer Deals

While three out of four airline passengers sign up for at least one of the 130-plus frequent flier mileage programs, far fewer really take advantage of membership. "Only about 10% to 15% are hard-core users," estimates Tim Winship, founder of **www.frequentflier.com** and co-author, with travel guru Randy Petersen, of *Mileage Pro: The Insider's Guide to Frequent Flyer Programs*. One hitch? With so many programs and continual rule changes, it's almost impossible to stay current about the best strategies for racking up and redeeming miles. But several websites stand ready to clue you in.

The mother lode is Petersen's **www.webflyer.com**. Five million readers a month click to the site, drawn by its global focus and a free bimonthly e-newsletter, *Miles Link*, that provides updates about specific programs. Webflyer also publishes *InsideFlyer*, a glossy monthly magazine ($45 a year for the print version, $12 online) that gives the latest news and reviews on airline, hotel, car rental, and credit card programs. Petersen's **www.Flyertalk.com** is a hot internet forum for mileage junkies.

Winship's **www.insideflyer.com**, which offers tactics for managing frequent flier points, won a *Forbes* magazine "Best of the Web" award for its easy "e-zine" style. Subscribers can get a free weekly e-newsletter, *Frequent Flier Crier*, to learn about new promotions. Winship says he regularly covers 20 airline programs, along with dozens



of hotel, car rental, and credit card deals, and the website has a great comparison of card mileage programs.

Winship is also one of many travel experts contributing to **www.smartertravel.com**, which covers leisure travel and frequent flier programs, particularly through its free *Mile Alert* e-newsletter. This consumer-focused website may be a good place for frequent flier novices to get grounded in the subject.

Other websites, including **www.Frequentflyer.oag.com**, combine frequent flier news with more general business travel information. The site's free biweekly *OAG Frequent Flyer Update* e-newsletter is meant for hard-core business travelers, according to editor Lisa Davis, with insider news, trends, destinations, and frequent flier deals. "We give insights into different ways to use the programs and be smart about miles," says Davis.

Business Traveller, a United Kingdom publisher, offers a U.S. version and eight other editions of Business Traveller, a magazine that covers general travel topics and includes "Loyalty Update," a column with the latest frequent flyer deals for each region. An annual subscription to the U.S. print version is $39.95 and includes access to a weekly e-newsletter, *BTe*, which focuses on frequent flier issues. In addition to its general **www.businesstraveller.com** site, the publisher offers customized sites, such as **www.businesstravelerusa.com**, which have headlines targeted to their geographic regions.

Finally, the website **www.airguideonline.com** offers extensive information on a global mix of frequent flyer programs through its weekly e-newsletter, Frequent Flyer Program News, for $24.95 annually. Some 20% of the newsletter's content appears for free on the website, says editor Aram Gesar. ●

What Happens To The Family Home?

house, say so. Then offer a plan for equalizing the inheritance, such as taking out a mortgage and paying your siblings with the loan proceeds.

4. **Don't wait to bring in a mediator.** If two people want the house or other disagreements surface, hire a disinterested third party to mediate before things escalate into a full-blown family feud. Your parents' estate attorney may be able to lay down some ground rules and diffuse any simmering emotional issues.
5. **Decide not to decide.** If emotions are raw and you can't reach consensus, just back away from the process for a little while. Set up a plan for maintaining the home and schedule a time to revisit the issue. If face-to-face meetings are difficult, ask everyone to write a letter explaining what they would like to have happen.
6. **Put it all in writing.** Whatever plan you come up with, the point-person should write everything down in painstaking detail, and then have all of the siblings sign off on it. Then, if you're doing this while your parents are living, add the plan to their will.●

Retirement Relocation: Five Mistakes

In his introduction to the fifth edition of *Retirement Places Rated*, a 300-page guide to the nation's best (and worst) golden-years destinations, author David Savageau makes a startling suggestion: Maybe you should just stay put. Retiring where you've spent your working life will give you more power, independence, and practical knowledge than you're likely to have anywhere else, Savageau says, and it gives you the one thing you can't take with you when you go: a deep sense of place.

But leaving the old hometown isn't the only mistake retirees make, according to Savageau. For those determined to leave, he offers five missteps to avoid.

Not forming a psychic connection with your destination. Finding an ideal retirement spot can take years of vacations, followed perhaps by buying a second home and spending time there in different seasons until you develop a sense of belonging that appreciates a place's benefits and forgives its liabilities. Many older adults don't take the time for this and either return home after a disappointing stint in Vegas or Florida or move on to another "promising" destination.

Obsessing too much about taxes. If you consider only states that don't tax personal income at all, you're limiting your search to just Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming. But if you look at states that either don't tax retirement income (Hawaii, for example) or that treat it favorably (Colorado and Georgia, among others), suddenly your quest for low-tax retirement will take in more than half the country.

Focusing only on resorts. Sure, Myrtle Beach, Hilton Head, and Palm Springs have their attractions. But their economies are defined almost exclusively by recreation. This can mean several things: higher prices for consumer goods and services; low-wage jobs, and unemployment in the off-season; and higher property-crime rates at the height of the season. Instead, consider locations that balance a recreation economy with an education economy (such college towns as Durango, Colorado, or Las Cruces, New Mexico) or a government economy (state capitals such as Austin, Texas, or Olympia, Washington).

Playing the pioneer. There's nothing wrong with searching for the next Aspen or Santa Fe, but don't expect it to be a little-known haven only you have found. Often, the reason a place is undiscovered is that it isn't a haven at all. Stick with locations that already have a population of newly arrived retired people. They're there for good reasons, and you'll never have to be the new kid on the block.

Avoiding urban areas. Most of us live in cities, and surveys show that most of us want out. Still, there is a small but growing trend toward retiring downtown. Developers are adapting warehouses, hotels, and office buildings into posh condominiums and apartments, and their biggest markets are young singles and older adults. Both groups are there for the culture and excitement. Redevelopment of handsome old masonry buildings is happening in places as diverse as Knoxville, Denver, Houston, Birmingham, Boston, and Chicago. ●

Charitable Giving Rules

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supported by an appraisal.

Very large non-cash gifts are also under fire. It may now be easier to trigger an IRS penalty for over-valuing a donation—even if you rely on an appraisal, which is required for gifts larger than $5,000. Though there are several exceptions that would get you off the hook, if those don't apply you'll be penalized when the amount you claim turns out to be more than one-and-a-half times what the tax agency decides the gift is worth. Previously, you got in trouble only if the misstatement was at least double the value. And now appraisers, too, will be fined if they prepare an appraisal that supports a misstated valuation.

Who may conduct "qualified appraisals" is also subject to tougher strictures. Now, an appraiser must have demonstrated experience and education in appraising the particular type of property involved, as well as a professional designation and membership in professional associations. And the appraiser must follow generally accepted rules, such as the Uniform Standards of Professional Appraisal Practice.

The rule changes regarding appraisals could affect taxpayers who want to take advantage of another pension act provision, which provides new, more generous tax breaks for conservation easements. An easement is a permanent restriction that protects a habitat or preserves land, open space, or historically significant structures.

For example, an owner might seek an easement that would forever prohibit development on his wooded 35-acre hillside parcel and its miles of views. Donating the easement to a conservation organization would provide the owner with a charitable income tax deduction because the restriction reduces the property's market value. "He would get a deduction for the decrease in value, and may also realize lower property and estate taxes," says Wesley Ward, vice president of The Trustees of Reservations, a Massachusetts preservation organization.

Deductions for easements donated in 2006 (even prior to the act's signing) or 2007 may be as much as 50% of income, or 100% for qualifying farmers and ranchers, and you can deduct anything exceeding those limits over the following 15 years subject to the same annual cap. Under the old law, you could deduct only 30% of income. ●

Information provided does not constitute individual tax advice. You should consult your tax advisor regarding your individual situation.