

2015

10 Reasons To Learn More About Charitable Giving and Tax Reduction

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Every few days I come up with a list of 10 ideas on a topic I have been thinking about. Usually they are nothing I would share with anyone and sometimes they aren't even related to my work. I got this "ten ideas" concept from another author, James Altucher (though he recommends doing this daily and becoming an "Idea Machine"). Occasionally, something valuable comes as a result.

As it is the end of the year for planning, I used the 10 ideas process to think through various reasons people might want to learn more about philanthropy and taxes. If any of the following strike a chord with you on the subject of charitable giving and tax reduction, a brief synopsis can be found below the list.

- 1) Make your philanthropic/charitable giving more efficient
- 2) Take a tax deduction this year for gifts far into the future
- 3) Have an asset you would sell but won't because you don't want to pay capital gains
- 4) Have always wanted to start a foundation and now is a good time to learn about it
- 5) Want to do well by doing good, enriching yourself and helping others
- 6) Transfer a business or valuable piece of property to your children/grandchildren/heirs (or trusts for them) with no estate tax and a nice income tax benefit to boot
- 7) Learn to pay tax on what you want for living expenses while growing the rest with no taxes
- 8) Want to make the world a better place
- 9) Hate paying such high taxes and really want to look at all the options you have
- 10) It's just something you have been thinking about

1) Make your philanthropic/charitable giving more efficient

Why not get two tax benefits out of a gift instead of one? According to IRS statistics, 80% of gifts to charity are in the form of cash while only 10% of the assets people own are cash. But here is the key point; while cash gifts typically generate tax deductions in the amount of the gift, an asset gift generates the same tax deduction dollar for dollar, but you also save the capital gains tax you would have paid if you had sold the asset to give cash to charity. So giving assets can create a two for one tax benefit. There are all sorts of other ways to make charitable giving more efficient and fortunately gifts like this are becoming more common.

2) Take a tax deduction this year for gifts far into the future

Many times gifting to charity is both a strategy to do good and a strategy to do well. Suppose you are asset rich but cash poor, or you're having a banner year in terms of income but you have reasons to hold onto the cash for now, such as reinvestment in your business. Perhaps you are selling an asset that's appreciated in value and you would like to avoid or defer the capital gains tax from its sale. Well, you're in luck, there are many ways to take deductions now for gifts or cash distributions in the future. One option is to use gifts of closely held stock, which can be redeemed later. Charitable trusts can offer many financial benefits as well. The choice of which strategy makes the most sense will be based on what you want to accomplish.

Are you paying tax on millions of income but living on a lot less? If so, this might be a conversation to have soon, as you could potentially increase your cash flow by 40% on business profit or income.

3) Have an asset you would sell but won't because you don't want to pay capital gains

There are trusts, known as Charitable Remainder Trusts designed to do three things:

1. Defer the realization of capital gains on the sale of property or equity;
2. At death, or at the end of some term of years, distribute what is in the trust to charity; and
3. In between, to distribute to you or your family a healthy income.

There are many forms and uses of Charitable trusts but most commonly, the idea is to produce more income from an asset than you would have otherwise generated by selling it outright. Since there is no capital gain tax paid when the asset donated to the trust is sold, it can produce more income when invested. All things being equal, because the resulting asset is up to a third larger than it would have been otherwise, it's capable of producing 33% more income. Plus, there is a nice tax deduction to boot, further increasing the financial leverage generated by this income planning tool.

4) Have always wanted to start a foundation and now is a good time to learn about it

If over the years, you haven't had time or resources to start a foundation but now think it's the right time to learn, consider this paragraph an introduction. First, there are two kinds of foundations, public and private. And, of course, there are some that sort of fit in the middle. There are some general differences to know about the two main types.

Private foundations generally have stricter rules imposed by government but they also allow for complete control. The basic rules are distribution rules (5% min per year), allowable deduction rules (30% of Adjusted Growth Income (AGI) - a term for all income in a year), and business rules (it can't do much business with its principle and typically only donor, such as rent space, etc.).

A public foundation, however, because it's not essentially controlled by you but by a board and over time must have many donors has less stringent rules. For instance, public foundations typically aren't required to meet the same distribution limits, allow for higher deduction limits of up to 50% of AGI, and would have more leeway to engage in various business activities with you, the donor.

5) Want to do well by doing good, enriching yourself and helping others

For many, the idea that you can redirect your wealth or arrange your situation such that you can control your tax bill, increase your income and leave to charity what would have

gone to taxes is not a surprise. What is a surprise is just how simply it can be done. For those people who have created real wealth, and by this I mean a substantial portfolio or a valuable business, it's a matter of taking a few steps and hiring the right advisers for the process.

The first step is vision. More than half of the people I have this conversation with have never thought through the big picture questions. You will never hit a target if you don't know what you're aiming for. Some questions I've found helpful in clarifying vision are:

- What would you do if you had to decide today where to send a million dollars to do some good in the world?
- If we were meeting here 3 to 5 years from today and looked back over that time frame, what would you have wanted to accomplish to feel good about your progress professionally and personally?
- Beginning with the end in mind, what, after having done everything you want to, do you want to leave behind regarding both your financial and non-financial legacy?

These can be tough questions, but answering them for yourself now can reap huge rewards.

6) Transfer a business or valuable piece of property to your children/grandchildren/heirs (or trusts for them) with no estate tax and a nice income tax benefit to boot

Let's say you have a successful business and you have decided that you want to transfer it to you children or other heirs in the most tax efficient way possible. Let's also assume that, all things being equal, you would rather give money to charity than pay taxes. Finally, assume you would like to have a retirement plan that supports you for the rest of your life, gives you investment flexibility, and has all the tax advantages of any retirement plan without any of the disadvantages. In other words you want your cake and you want to eat it too.

There are so many ways to do this that there isn't time or space here to cover them all but here is a simple example:

1. Make a gift of some portion of the business, less than 100%, to a charitable trust.
2. Sell or give the small portion of the business not in the trust to your successor(s).
3. The business redeems those shares that are in the trust so that the only outstanding shares are owned by your successors.

The results of this process are:

- a. There is no tax on the transfer of the business.

- b. You are the beneficiary for life of all the income the trust produces (and this can include growth too!).
- c. There is no estate tax on the business transfer.
- d. The growth and income your trust produces which you don't distribute to yourself grows tax free.
- e. When you die, your favorite charity or foundation is going to get what would have gone to the government in taxes.

7) Learn to pay tax on what you want for living expenses while growing the rest without taxes

We call this the maximum stewardship plan. It involves some thought upfront but if you have read some of the other examples, this essentially follows the same vein. The issue for many is this: you have a portfolio or business that produces a lot of taxable income but you aren't spending all that income. In fact, for many, their tax bill exceeds their personal spending.

One idea is to transfer some of that portfolio or business interest into trusts that are not taxable and continue to invest and grow your wealth there. Each year, you decide how much to distribute (within the limits you set at the trust creation) and only pay tax on the portion that you are using to fund your lifestyle. Everything else grows tax free.

8) Want to make the world a better place

It may seem like the way to make the world a better place with your money is to give cash to charities or even get involved in philanthropic work. No doubt, these are fantastic things to do. However, if you really want to have an impact, and unlock what can be accomplished regarding philanthropy, whether it's giving to your church, missions, poverty reduction, or the arts; taking the time now to think through how your assets, along with legitimate tax reduction techniques (tax avoidance, not tax evasion), can leverage your giving may well multiply what you thought possible.

9) Hate paying such high taxes and really want to look at all the options you have

Sometimes I talk to people and the primary thing that comes across is how sick and tired they are of paying so much tax. When you look at the amount of tax on a dollar of profit it's staggering. First there is the Federal income tax of up to 39.6% for top earners. Then, if you invest what remains, there is a capital gains tax on any profits when you sell, which can go as high as 23.8% with the Net Investment Income Tax applied. Finally, when you die you can pay another 40% on what you leave to your heirs over and above any non-taxable exclusion amount.

I certainly understand and empathize with the desire to avoid tax. And here's the thing, the tax code encourages legitimate tax avoidance and one of those ways it does so is through philanthropy. There are other ways too, for a different discussion in a different time and place. But what I want to emphasize is that there are options. Combining

philanthropy with other kinds of plans can really add to your bottom line. Leaving philanthropy out of your planning on the other hand reduces the options you have for building and enjoying your wealth.

10) It's just something you have been thinking about

Creating wealth creates complexity. For many, philanthropic planning seems like it would add complexity to an already complex situation. But maybe in the back of your mind you have thought about learning more about it and delving into it at some point in the future, perhaps when things get simpler. Well, I have news: Things don't get simpler unless you simplify them. Philanthropic planning, when done correctly, can be a simplifying experience. It can be a problem solver for family wealth challenges, can provide meaning where it's been difficult to do so, and reduce taxes and the role the government plays in your finances.

Sometimes, the sheer complexity and effort of wealth creation and maintenance has either crowded out or reduced the meaning or enjoyment which should be a part of being wealthy. Anyway, maybe now is the time to learn more.

In conclusion, it's the middle of November by the time you get to read this, so there is still time to reduce taxes this year. However, for it to work for this year, it has to be done by the end of the year. For many, perhaps the first step is putting a small plan in place that reduces this year's tax bill by up to one third but doesn't require out of pocket cash this year and very little next year. For others, maybe something more comprehensive is appropriate. We'd be glad to have a conversation with you and work together to determine which solution best meets your specific needs.

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