

# FINANCIAL GUIDE

For Friends of  
**PURDUE**  
UNIVERSITY

Spring 2005

## The Campaign for PURDUE

Dear Friends,

An annual checkup can help ensure robust physical health and alert you to any problems that need to be corrected. You can reap the same benefits for your financial health with an annual “checkup” at tax time.


As you ponder your tax form, ask yourself such questions as: Have I taken advantage of all strategies to reduce capital gain? Have I used tax-advantaged programs to put away enough for an enjoyable retirement? Finally, have I reduced my gift and estate taxes with gifts to my family, friends, and charities such as Purdue University?

Just as your doctor may offer tips on reducing your cholesterol or blood pressure, this issue of the *Financial Guide* offers tips for reducing your taxes. Some of the most effective ways are through a carefully considered charitable gift to Purdue. Besides holding on to more of your money, you have the satisfaction of supporting a cause you believe in.

To help with your planning, I would like you to have a copy of our free booklet, *Givers Guide to Federal Taxes '05*. To request your copy, simply return the enclosed card or call our office. I would be happy

to discuss with you these means of helping you reduce your taxes and support Purdue. Please call our office or e-mail us.

Sincerely,



Gordon D. Chavers  
General Counsel



## Tax-Planning Checkup: How Did You Do?

**April 15** is more than just a day of reckoning with the IRS. It is a day of assessing how effective you were in planning your tax strategy for the previous year. Did all of your moves turn out like you expected? Was there an opportunity or two missed?

In this issue of the *Financial Guide*, we invite you to evaluate your tax-planning performance by taking our **Tax-Planning Checkup**. Answer the questions, add up your score, and see how you did. We hope you have a little fun with this exercise, and we hope it might bring to light some opportunities to improve your outcome this year.

### INSIDE

[Capital-Gain Strategies](#)

[Making the Most of Charitable Deductions](#)

[Taking Interest in Your Deductions](#)

[Securing Your Retirement](#)

[Addition by Subtraction](#)

[Summing Up](#)

[Send for Our Booklet](#)

## Capital-Gain Strategies

How did your investments fare last year? Did they follow the trend of most of the major indices and go up in value, or did they lag behind? As strange as it may seem at first, how your investments performed and the impact on your tax picture are two completely separate matters.

Gain and loss are just paper transactions until you actually sell an investment. It is only realized gain and loss that show up in your tax picture from year to year. Because you control the timing of buy-and-sell decisions, you have significant control over the impact these transactions have on your taxes.

**• Checkpoint 1** **If you sold losing stocks before year-end to generate a realized capital loss, give yourself 10 points.**

Your capital gain and loss are “netted against each other” to determine the amount and nature of what is reported on your tax return. If you have realized gain during the course of the year, it is generally a good idea to sell some of your losers to offset that gain. Investments in which you have

***It's a good idea to sell losing stocks to offset capital gain.***

lost confidence are the best choices to sell, but any stock sold at a loss will work. Remember, though, you have to wait more than 30 days to buy a stock back or you cannot recognize the loss for tax purposes. Even if you do not have gain to offset, you can use loss to offset up to \$3,000 of ordinary income.

**• Checkpoint 2** **If you waited until after the end of the year to sell a stock at a gain, give yourself 10 points.**

Sometimes delaying a sale just a few days can push the tax consequences into the next tax year. Again, don't let tax considerations alone dictate your decisions. If you believe a stock is sinking fast, it may be better to sell and deal with the tax consequences than to risk further erosion of the price of the stock.

## **Making the Most of Charitable Deductions**

Of all the deductions that save you taxes, the charitable deduction is the most flexible. **Reason:** You have complete control over the amount and timing of your charitable gifts as well as over the choice of what kind of asset you will give.

**• Checkpoint 3** **Give yourself 10 points if you were able to claim a charitable deduction on your tax return.**

If you itemize deductions, your charitable-contribution deductions generate tax savings proportional to your *marginal tax bracket*.\*

**Example:** Last year Phil made a \$10,000 gift to Purdue. Since Phil is in the 33% federal income-tax bracket, that gift saved him \$3,300 ( $33\% \times \$10,000$ ) in taxes.

\*Send for our follow-up booklet for an explanation of this term.

**• Checkpoint 4** **If you accelerated this year's charitable gift into last year in order to reap the benefits of itemizing, give yourself 10 points.**

For many people, itemizable deductions come close to equaling the standard deduction each year but never quite exceed that amount. Consequently, those taxpayers elect to use the standard deduction each year.

If you find yourself close to but short of the standard-deduction threshold, you might want to consider doubling up on your charitable giving in that year and skipping the next. You will realize savings to the extent your extra gift causes your itemized deductions to exceed the standard deduction. And, even though you will not be making a charitable gift the next year, your tax bill will not increase because you will still be able to use the same standard deduction you would have used if you had spread your gift over two years.

**• Checkpoint 5** **Give yourself 10 points if you used long-term appreciated securities or real estate to make your charitable gift.**

A sale of an investment to capture gain comes with a price tag: the gain is subject to tax. Creative charitable planning offers an attractive alternative that lets you enjoy the full benefit of your gain.

***Avoid paying tax on gain by making your gift with appreciated securities or real estate.***

If you use long-term appreciated securities or real estate to fund your charitable gifts, you not only are able to deduct its full fair-market value but you also avoid recognizing or paying tax on any of your paper gain.

**Example:** Ruth G contributed stock worth \$30,000 that she had bought five years ago for \$10,000. If she had sold the stock, she would have faced a tax of \$3,000 on her \$20,000 gain ( $\$20,000 \times 15\%$  capital-gain tax rate). In her 35% federal income-tax bracket, the \$30,000 gift produces \$10,500 of income-tax savings as well ( $\$30,000 \times 35\%$ ).  
**TOTAL SAVINGS: \$13,500.**

## Taking Interest in Your Deductions

Many people are disappointed to learn they cannot deduct interest on auto loans, credit card obligations, and other kinds of “consumer” interest. The tax code does, however, allow a taxpayer to deduct mortgage interest on a loan secured by a personal residence in most circumstances.

• **Checkpoint 6** **Did you obtain a home-equity loan to replace nondeductible consumer credit? If so, give yourself 10 points.**

Be sure to check with your advisors to be certain the interest on your home-equity loan qualifies for deduction. And, remember, when you take out a home-equity loan, you are putting your home on the line as security, so be very conservative in obtaining and using this kind of credit.

## Securing Your Retirement

Retirement security is a topic near and dear to the hearts of nearly all Americans. Federal tax laws encourage taxpayers to put money away for retirement through a variety of tax-advantaged programs—from nondeductible contributions to Roth IRAs that make tax-free distributions at retirement to a number of deductible plans that generate taxable retirement income. One key advantage to all of these programs: income and gain within the account are not subject to current tax.

• **Checkpoint 7** **Give yourself 10 points if you made a contribution to a tax-advantaged retirement program last year.**

**Combining Objectives.** If you have major charitable goals in addition to a desire to enhance your retirement security, you can address both

**Receive retirement income and help Purdue University with a life-income gift.**

such plans can be arranged so that most or all of the income is paid after your retirement.

objectives simultaneously with some creative planning. It is possible to make charitable gifts that pay you an income for life—and often

• **Checkpoint 8** **Add 10 points to your total if you completed a charitable life-income gift last year.**

*Example:* Joe and Helen T, both aged 65, hardly expected XYZ, Inc. stock to go to \$125 per share when they purchased 5,000 shares at \$10 per share in the mid-nineties. True, it has pulled back to \$80 per share, but Joe and Helen still do not like having \$400,000 tied up in just one stock. They would like to sell a substantial portion of their position but are reluctant to do so since a sale would generate capital-gain tax of \$10.50 per share. To complicate things even further, XYZ, Inc. pays no dividends and, now that Joe and Helen are retired, they would like to get more income from their investments.

**Increase your current income by funding a charitable trust with non-income-producing stock.**

After explaining their objectives to their advisors and a member of our staff, Joe and Helen decide to use 2,500 shares of XYZ, Inc. to create a charitable remainder unitrust that will pay them 5% of its annual value each year for the rest of their lives. By placing \$200,000 worth of stock in the charitable remainder unitrust, Joe and Helen avoid \$26,250 of capital-gain tax and generate a charitable deduction of \$70,214. That saves them \$24,575 in their 35% federal income-tax bracket (35% x \$70,214).

The first year Joe and Helen will receive \$10,000 (5% of \$200,000), and that could increase in the future. If the trust achieves a 9% total return and Joe and Helen live their normal life expectancies, their annual payment will reach \$25,633 and \$533,167 will eventually pass to Purdue.

**Planning pointer:** The trustee would be able to sell the stock without incurring capital-gain tax and reinvest the proceeds in a diversified portfolio. If Joe and Helen want to achieve even further diversification, they could consider selling even more of the XYZ, Inc. stock they retain and using their charitable deduction to offset any gain they realize on the sale.

We would welcome the chance to discuss how this or another type of life-income plan can address your retirement-planning and charitable goals. Please contact us if we can be of assistance.

## Addition by Subtraction

We all hope for a successful year in regard to our financial matters, typically judging success by the relative increase or decrease in net worth. While a substantial increase in net worth is gratifying, it can bring with it hidden future challenges. At some point our focus shifts to the best—and most tax-efficient—way to pass assets on to family and other individuals and to charitable organizations whose work we value. The hidden challenge in all of this can be the federal estate- and gift-tax system.

Currently, taxable transfers, either during life or at death, can be subject to tax up to 47%. Each individual can make up to \$1,000,000 of taxable transfers during life without any out-of-pocket tax cost thanks to a credit against the gift tax. At death, it is possible to pass on up to \$1,500,000 of combined lifetime and testamentary gifts with no federal estate-tax cost.

Federal tax law also affords a kind of “bonus” to each taxpayer by allowing gifts of up to \$11,000 per recipient each year that do not count against these lifetime or cumulative limits. Utilizing this *annual exclusion* is a great way to reduce the potential impact of the estate and gift taxes on how much eventually reaches your intended beneficiaries.

• **Checkpoint 9** Give yourself 10 points if you made a tax-free annual-exclusion gift to one or more individuals last year.

There is a double benefit to using the gift-tax annual exclusion. Doing so not only removes potentially taxable assets from your estate but also passes the appreciation on to those assets on to the recipient free of estate or gift tax.

**Gifts cost your estate less because of the charitable deduction.**

**Charitable Gifts Escape Tax.** The actual cost of a gift in your estate to Purdue may be substantially

less than it initially appears. *Reason:* Such gifts qualify for a charitable estate-tax deduction. The cost of a charitable estate provision currently may be reduced by as much as 47%, the amount of the current maximum estate-tax rate.

• **Checkpoint 10** Have you included charitable provisions in your estate plans? If so, give yourself 10 points.

*Note:* The exemption for the federal estate tax is scheduled to increase to \$3,500,000 in 2009, and the estate tax is scheduled to be repealed in 2010. However, absent specific action by Congress, the tax will return in 2011 at levels provided by the law in effect prior to the 2001 tax act.

## Summing Up

Based on our checkup, were you successful in your planning last year? The following chart may give you an idea of where you stand:

Points	Ratings
0 - 20	Plenty of opportunities to improve this year
30 - 50	Good start
60 - 80	Solid performance
90 - 100	Planning all-star

## Send for Our Booklet

We hope you have enjoyed this exercise and find it beneficial. As you look to the future, we would like you to have a complimentary copy of our booklet, *Givers Guide to Federal Taxes '05*, to assist with your charitable planning. Just return the enclosed postage-paid card or call our office to get your copy.

You should consult your attorney about the applicability to your own situation of the legal principles contained herein.

40

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