Flash
News from the Pomona Plan
A Financial Guide for Friends and Alumni of Pomona College (800) 761-9899
Summer 2008

Death and Taxes Are Certain; the Estate Tax Is Arbitrary

"I'm afraid I must concur with Dr. Hamilton and Dr. Movin. The cause of death was taxes."

Timing is everything Imagine a Monopoly game that mimics the current estate tax rules. The card that used to read "Pay Tax Collector $200" now says "Pay $2,000 if you land at 8 o'clock; pay $1,500 if you land at 9 o'clock; pay nothing at all if you land at 10 o'clock. But if you land at 11 o'clock or later, pay $4,000."

That's analogous to the changing estate tax exemption over the next couple of years: $2 million this year, $3.5 million in 2009, complete repeal of the tax in 2010 but a return to the $1 million exemption in 2011 and beyond.

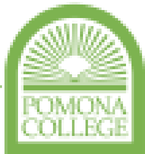
What to do The conventional wisdom among estate planning lawyers is that Congress will revise the estate tax before the 2010 and 2011 rules apply. But for safety's sake, many lawyers provide protection and flexibility by taking the changing exemptions into account. So, for example, the terms of the Will (or living trust) can give a beneficiary the right to disclaim all or part of a bequest with the disclaimed property going to a designated individual.

Another way is to provide that "If the exemption is $2 million, I bequeath [what property and to whom]; if it is $3.5 million, I bequeath [what property and to whom]; if there is no estate tax, I do the following: [specify]." (Note that state transfer taxes must be taken into account.) For some individuals, lifetime transfers are a useful estate reduction strategy.

Tax-free transfers Current law provides for a lifetime $1 million gift tax exemption, but many gifts can be made without using that exemption. The law recognizes and encourages those transfers by allowing individuals to make unlimited tax-free gifts to U.S. citizen spouses and to charity; limited gifts to non-citizen spouses; annual exclusion gifts of $12,000 a year to as many people as you wish; and gifts to pay some medical and educational expenses.

The annual exclusion Single taxpayers can give $12,000, and married couples $24,000, every year to as many family members and others as they wish—and to the same individuals each year.

(Continued on page 2)



Inside:

- Protect Yourself and Your Family with a Durable Power of Attorney
- Saving Taxes with a Home Office Deduction
- Leave State Taxes Behind When You Move

© The New Yorker Collection 1977 Henry Martin from cartoonbank.com.All Rights Reserved.

Newsletter © Conrad Teitell 2008

Protect Yourself and Your Family with a Durable Power of Attorney

If you were suddenly to become seriously ill or incapacitated, is there someone who could legally handle your affairs? Creating and signing a "durable power of attorney" can give a trusted individual that legal authority and bring peace of mind to you and your family.

Q. Why do I need a durable power of attorney?

A. A regular power of attorney is a legal document that empowers another individual (the "attorney-in-fact" who need not be a lawyer) to act on your behalf in financial or legal matters. It goes into effect as soon as it is signed and automatically ends if you revoke it, become incompetent, or die.

A durable power of attorney, however, can go into effect immediately or at any future time you (the "principal") specify—generally if you were to become unable to make decisions for yourself—and remains valid unless you revoke it or die.

Signing a durable power of attorney does not mean that you automatically cease to be responsible for your own affairs. It does mean that a trusted person, your attorney-in-fact, is able to act for you when the need arises.

Q. How can I be sure the person I've named to act for me will make the right decisions?

A. When appointing an attorney-in-fact, look for the same qualities you'd want in anyone you would choose to be your adviser or agent: reliability and sound judgement.

An attorney-in-fact is legally responsible for acting in your best interests at all times. He or she must keep meticulous records of all transactions on your behalf and avoid conflicts of interest. The power of attorney document should require him or her to provide periodic accountings to you or to a third party designated by you.

Some people appoint two attorneys-in-fact (you must specify if they can act separately or must act together) or name a substitute to serve if one is unable to act.

Q. What can a durable power of attorney do for me and my family?

A. Depending on what powers you delegate to your attorney-in-fact, he or she can use your assets to pay bills and everyday expenses, buy and sell property on your behalf, make investments and handle any other financial transactions you specify.

If so directed, he or she can also continue to make gifts to charities, family members and others on your behalf.

Q. Can't a living trust handle my affairs in the same way?

A. Generally, no. If you become incapacitated, the successor trustee's powers are limited to the property that has been placed in your revocable living trust—not all your assets.

Q. Can I authorize the attorney-in-fact to make medical decisions if I can't speak for myself?

A. No. The durable power of attorney applies to your financial affairs only. You must create a durable power of attorney for healthcare to carry out your wishes for medical treatment.

Creating a durable power of attorney is easy You need only sign and have notarized a simple legal document. State laws vary and some have their own specified forms and require witnesses, but the forms are easily and inexpensively available from many sources on the internet.

Although you will most likely want to consult a professional adviser before signing such an important document, you don't need a lawyer to create a durable power of attorney and there are no court proceedings.

Estate Tax (Continued from page 1)

Life insurance With proper planning, a policy can be put into an irrevocable life insurance trust and the proceeds won't be subject to estate tax.

Charitable gifts There is no limit on the amount you can contribute. And itemizers can claim an income tax charitable deduction for lifetime gifts up to 30% to 50% of adjusted gross income (depending on the asset contributed) with a 5-year carryover for any excess.

A tax trap to avoid Proceeds from a retirement plan payable to children or grandchildren can be taxed twice or even three times—as part of your estate, as income to the beneficiary, and yet again if generation-skipping tax is involved. Proceeds from an IRA or other plan left to Pomona College, however, incur no tax whatsoever.

Charitable bequests Outright bequests are easy to plan for under current law. The estate tax charitable deduction is unlimited for outright bequests to Pomona College—so no estate tax is payable regardless of the size of the bequest.

Considerations beyond taxes Planning for gift and estate taxes is only part of the story. Estate planning involves carrying out your philanthropic wishes, protecting the assets of beneficiaries, and providing for management of your assets if you are no longer capable (see above: "Protect Yourself and Your Family with a Durable Power of Attorney").

Tax savings should always be kept in mind, but don't let the prospect of those savings thwart your wishes for the disposition of your property or plans for your family.

Consult your lawyer Estate tax saving techniques are available to everyone. Whether those techniques make sense for you depends on your personal and philanthropic objectives, your assets, and your wish to make gifts during your lifetime.

Saving Taxes with a Home Office Deduction

If you've joined the ranks of post-retirement entrepreneurs, telecommuters or others who use part of their homes for business, you may qualify for a federal income tax home office deduction for certain expenses (described below). The deduction is limited if your gross business income is less than your total expenses.

Claiming a business deduction The deductible part of your home (it needn't be marked off by a permanent partition) must be used *exclusively* and *regularly* as your principal place of business or as a place you meet with clients or customers as a substantial and integral part of your business.

You can deduct expenses for a free-standing structure (e.g., a studio, garage or barn) that's not your principal place of business as long as you use it exclusively and regularly for the business.

There are exceptions to the exclusive-use-test if you use part of your home on a regular basis to store inventory or product samples (certain tests apply) or as a licensed daycare facility.

The trade-or-business test Expenses relating to the exclusive and regular use of space to handle your own investments aren't deductible unless you're a broker or dealer conducting a trade or business.

What if you don't run your own business? If you work from home—making or answering phone calls or telecommuting, for example—you can deduct expenses only if the regular and exclusive use of the working space is for your employer's convenience and is not rented by the employer.

Deductible expenses If you meet the above tests, you can deduct a percentage of expenses such as real estate taxes, insurance, rent, repairs, and utilities attributable to the business use of your house. You can use any reasonable method to calculate this percentage. Most common: as a portion of the total square footage or as a fraction of similarly sized rooms in the house.

Not a way to write off ordinary household expenses Deductible expenses are those that are ordinary and necessary to conduct your business. A good example is basic local telephone service. The first line into your home is a personal expense; charges for business long-distance calls and a second, exclusively business, line would be deductible expenses.

Consult your adviser as to how these general rules fit your situation and keep complete and accurate records to substantiate all your deductions.

Leave State Taxes Behind When You Move

Thinking of relocating to the popular sunbelt destinations, Nevada or Florida, or one of the other five U.S. states with no income tax—Texas, Alaska, Washington, South Dakota, and Wyoming? Make sure you don't take your old state's tax bill along.

Your move must look real to an auditor Many states, especially those with high income and estate taxes, have become aggressive in pursuing departed residents. Especially suspect are individuals who own a house there or maintain other ties to their former states.

Register to vote, get a driver's license and register your car in your new state. And show other evidence of intent: sign a new Will, change your address for credit card bills and on official documents, take personal items like jewelry and family photographs. Tax examiners may also look at club and church memberships and other involvement in the new community as indications that you have truly changed your domicile.

No state income tax doesn't mean no tax When comparing the relative tax burden of your present home state with others, keep in mind that many states and municipalities impose a variety of other taxes such as on real and personal property or interest and dividends. And some states levy their own tax—often with a lower exemption than the federal tax—on estates.

Keep in mind: The rules are complicated and vary from state to state. It's often advisable to seek professional advice before you pull up stakes.

FROM THE DIRECTOR:

Problem Solved!

One of the trickiest problems is how to plan your estate. Congress hasn't provided guidance yet on how estate tax laws will be revised. One constant on which you can rely, though, is charitable giving. Sometimes, you can profitably combine giving with passing assets to heirs. If you have a sizeable estate, current low interest rates provide an opportunity for establishing a charitable lead trust.

Here's a problem: for someone who has a taxable estate (over $3.5 million in 2009 but soon to be lowered to anything over $1 million), how can you avoid up to 55% estate tax? If you have children, grandchildren, nieces, nephews, or valued friends you'd like to benefit, you may find 'too much' being levied in tax.

Let's say that you fund a charitable lead annuity trust with $2 million. That amount comes out of your estate, thereby lowering your estate tax. If the lead trust pays 6.5% to Pomona College for 15 years before releasing its assets to those valued heirs, there will be no gift tax. This will be true if you have, say, half of your transfer tax exemption equivalent still available. In other words, you have made some taxable gifts already, but you can still make $500,000 in gifts without incurring gift tax.

Pomona will receive an annuity of $130,000 per year for 15 years. You might endow a scholarship with those gifts. If the trust's assets earn 8% per year, the trust would increase in value and release $2.8 million to your heirs. They will receive more from your estate than they would have if you hadn't established the trust. Problem solved!

We urge you to talk to your financial adviser about a charitable lead trust. We'll be glad to send you the calculations from this example or run an illustration tailored to you.

Thank you for considering the *Pomona Plan.*

Robin Trozpek

Robin Trozpek

Trusts and Estates
550 N. College Avenue
Claremont, CA 91711
800-761-9899
909-621-8143
909-621-8654 fax
pomonaplan@pomona.edu