Financial Decisions

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Being An Informed Donor: The Realities Of Charity

Charitable giving in 2013 is slated to increase only 1.6 percent from last year, a bleak figure that will likely decline even further if charitable deductions are scaled back by congress. One new tax law limitation – the so-called "Pease rule" – already reduces charitable deductions for certain high-income individuals.

Due to the potential decrease in giving, it's more important than ever to make sure your dollars are having maximum impact. You need to know about the organizations you support—how they're using your money, how efficiently they're run, and whether they're living up to their missions. In order to get a tax deduction for your gifts, you also need to have proper acknowledgement from the charity and adhere to the IRS's recently toughened requirements. These are the new realities of charitable giving.

The internet has greatly simplified the process of finding a charity, learning about its mission, and doing due diligence before you contribute. Guidestar.org, for example, maintains a directory with information about almost two million charities recognized by the IRS. You can search the database for a particular organization or use keywords, location, and other criteria to look for groups with a specific mission. Type in "homeless" and click Arizona, for instance, and you'll get a list of 200 or so organizations.

Guidestar and other sites provide comprehensive information about a charity's activities. Charity Navigator (charitynavigator.org) evaluates the financial health of more than 5,400 of America's largest charities, while the Better Business Bureau (bbb.org/us/charity) offers a wealth of resources for both charities and consumers. Its "Wise Giving Guide" summarizes the results of recent evaluations of charitable organizations and provides tips on gift-giving and charitable accountability issues. The American Institute of Philanthropy operates a website (charitywatch.org) that grades more than 500 public charities and focuses on special issues such as compensation for charity executives, top-ranked groups, and other "hot topics."

With all of this information literally at your fingertips, it's easy to dig deeper. Find out how much of a group's budget goes to its programs and how much is earmarked for fundraising, other administrative costs, and overhead. (Most organizations should allocate at least three-quarters of their spending to programs.) Look at a charity's annual reports to evaluate its finances and its commitment to its mission. Be wary of those that have consistently operated at a loss. You can read more financial details in the Form 990 every charitable organization must file with the IRS. Look for a copy on the group's website or call to request one.

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Thank Goodness That's Over!

This fall marked the fifth anniversary of the 2008 financial crisis, which led to the "Great Recession" and impacted financial systems around the world. Our C.I.O., Ken Gutwillig, recently attended the G30 International Banking Seminar in Washington, D.C., and came back reporting "the crisis is over." Here are some of Ken's takeaways from those meetings:

According to Fed Chairman Ben Bernanke, the causative factors of the crisis, housing and credit, both are much improved. Also, annual bank stress tests have been successful; neither liquidity nor reserve requirements are constraining lending. And state and local governments are healthier; they are no longer a drag on economic growth.

Europe, in recession for three years, is finally up off its back. ECB Vice President Vitor Costancio reported that all EU members will see economic growth in 2014.

Haruhiko Kuroda, Bank of Japan governor, was excited that "Abe-nomics is working!" Japan's bond buying and fiscal spending have jump-started nascent inflation and pushed down yen prices.

FDIC Chairman Martin Gruenberg reported that the new program for monitoring Systemically Important Financial Institutions ("too big to fail") is operational and ready to be implemented whenever the next crisis arises.

So, even if these aren't the best of times, the world's economies have turned a corner, and brighter prospects are ahead.

Florence Dupont, Ken Gutwillig,

and Linda Schoenthaler

Common Investment Mistakes

One thing that can be puzzling about stock market investors who have struggled in the past: They make some of the same mistakes over and over. Here are seven prime examples.

1. Trying to "time" the stock market. Typically, timing strategies are based on selling stocks when you believe the market has topped out and buying when you think it has hit rock bottom. The problem is that nobody—and we mean NOBODY—has a crystal ball that's foolproof. It's far better to stick with a well-diversified, balanced portfolio, with an allocation tailored to your personal circumstances.

2. Having zero patience. If you're looking for instant gratification, the stock market will disappoint you more often than not. Just as for the tortoise and the hare, slow and steady usually wins the race, while those who act too swiftly finish behind. Be content to hold some stocks for a long time before you reap rewards.

3. Refusing to recognize reality. All too often, investors operate with blinders on, but the cold hard facts can't be ignored. If you have a favorite stock you were convinced would turn a profit and it simply hasn't worked out, or a poorly performing stock that holds sentimental value for you, don't throw good money after bad. Dump the losers and hold on to the winners without allowing emotion to rule the day.

4. Putting all of your eggs into one basket. No matter what the projections are for any particular stock, sector or asset type, it's not smart to bet your entire wealth on its performance. Diversification is a key element of a sensible plan for virtually every investor. It's all about balancing the search for reward with the need to reduce risk. Although there's less chance you'll make a killing if you diversify, you reduce your exposure to a catastrophe.

5. Overemphasizing past performance. It may be boilerplate language in investment prospectuses and related materials, but it's also true: "Past performance is not necessarily indicative of future results." Don't build your portfolio around particular stocks just because they've been profitable without evaluating their current and future prospects.

6. Ignoring the impact of taxes. While it is a mistake to let taxes drive your decisions, it makes sense to consider the tax ramifications—especially now, with higher tax rates and the recent arrival of the 3.8% Medicare surtax. Weigh all of the relevant economic factors before you buy or sell stocks.

7. Not having a plan. Many investors take a hit-or-miss approach to their portfolio. They buy and sell on whims without coordinating their activities. But you're more likely to be successful if you develop an overall plan that is suitable for your situation. Having a strategy and having the discipline to stick with it is the hallmark of successful investing. An objective investment advisor can help you follow the plan and avoid these common errors.●

Planning for Retirement and Beyond

Everyone needs a financial blueprint for life after work. Operating without one is a little like closing your eyes as you barrel down the freeway. It's essential to know where you're going and how you expect to get there. A financial plan will help you achieve your goals if it is based on accurate assumptions regarding your retirement. It is incredibly important to understand its component parts and how they're connected while developing your plan. Consider these elements:

Cash flow analysis. Your plan needs to reflect current and realistic estimates of your expected inflows and outflows going forward. What will come in during retirement, from Social Security, a company pension, annuities, investment income, and from drawing down your assets? And will the inflows support your anticipated lifestyle in retirement? Several unpredictable variables complicate these calculations. Inflation affects how far your money goes, and investment returns, based in turn on economic and market cycles and your choices, determine how much you have to spend. Taxes will also play a role.

Investment choices. Two factors affect what should be in your investment portfolio. Your risk tolerance: How much volatility in portfolio returns are you willing to accept to help you meet your goals? Taking greater risks may provide higher potential long-term returns, but not if you panic and sell when the market takes a turn for the worse. Your time horizon: How long do you have to save for retirement, what is your tax bracket, and how many years do you need your asset

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The Renaissance In Life Insurance Trusts

An age-old estate planning technique is enjoying a revival of sorts due to recent tax law developments. If you don't already have an irrevocable life insurance trust (ILIT) in place, you might consider creating one, or you might add a policy to an existing trust. Despite some cracks in the foundation, this remains one of the top tax shelters available to upper-income individuals.

Start with the premise that life insurance proceeds paid from a policy on your life are exempt from estate tax only if you don't possess any " incidents of ownership" in the policy. Naturally, that applies if you own the policy outright, but that's not all. For instance, you will be treated as having incidents of ownership in life insurance if you retain the legal right to:

- Change or name the beneficiaries of the policy;
- Borrow against the policy or pledge any cash reserve it has;
- Surrender, convert, or cancel the policy, or;
- Choose a payment option for beneficiaries (that is, you determine whether payments will be made in a lump sum or installments).

Be aware that these rules apply if you have *the right* to do any of these things regardless of whether you actually do them. If you have a policy with a large death benefit and the proceeds end up being part of your estate, this could have tax consequences for your heirs.

Fortunately, it's relatively easy to avoid incidents of ownership. All you have to do is establish an ILIT and transfer ownership of the policy, including all of the legal rights discussed above, to the trust. You'll also need to designate someone—a professional, family member, or friend—to serve as trustee. If you acquire additional life insurance protection, you can designate the ILIT as the owner of your new policies.

An ILIT can be "funded" or "unfunded." If it's funded, not only do you transfer ownership of the life insurance policy to the trust, you also transfer other assets that may be used to pay the premiums. The additional property may be in the form of cash, securities, or some other asset. The major drawback of this approach is that the income the trust generates is generally taxable to you.

Unfunded trusts are more common. In this case, you don't transfer assets to the trust to pay for the premiums, but rather you make annual gifts to the ILIT for this purpose.

The ILIT technique provides some other benefits that may appeal to wealthy taxpayers. With the appropriate wording of trust documents, you can protect the money from spendthrift heirs. Furthermore, the proceeds may be used to cover estate tax liability without diluting other assets intended for the family.

How much estate tax flexibility do you have under current law? Plenty. Thanks to the American Taxpayer Relief Act of 2012 (ATRA), an exemption of $5 million (indexed to $5.25 million in 2013) effectively shelters bequests to non-spousal beneficiaries like your children and grandchildren. In other words, if you remove life insurance proceeds from your estate through an ILIT, you could possibly leave another $5.25 million to your heirs free of federal estate tax. ATRA also establishes a top federal estate tax rate of 40%.

For example, consider the implications if you have a policy with a $1 million death benefit. Without an ILIT, your family might have to forfeit up to $400,000 of the proceeds to Uncle Sam.

Keep in mind that to qualify for this estate tax break, the life insurance trust must be "irrevocable"—you can't change your mind once you pull the trigger on the deal. Also, if it's a policy on your life, you can't be the trustee. If you don't observe those rules, the life insurance proceeds could end up back in your taxable estate.

Finally, when you set up an ILIT, the proceeds don't have to go through the probate process, and your heirs should have access to the cash in a relatively short time. But there's one last wrinkle to consider for existing policies: Under a little-known tax rule, the proceeds will still be subject to federal estate tax if you die within three years of transferring ownership to the trust. Because of this three-year rule, don't delay if you think an ILIT is advantageous for your current policy. Set up the trust now to start the clock running.

Tax law crackdowns have eliminated some traditional tax shelters—and Congress has its eye on others—but the benefits of life insurance trusts remain intact. ●

base to last?

Contingency plans. Job losses, expensive illnesses, or the unexpected death of you or your spouse could put your plan off track. There could also be unforeseen expenses involving your children or parents, and the need for nursing home care during retirement could quickly drain your assets. Access to liquidity, along with life, disability, and long-term care insurance, can prepare you to handle potential setbacks. Not planning for lifestyle changes is a major mistake and could put your financial future in jeopardy.

Beyond. If you have more than enough of an asset base to fund your desired lifestyle throughout retirement, you may want to think about those who will survive you- your spouse, your children, other dependent relatives. Will they need income from an inheritance? Or, are you interested in using surplus assets to create a different type of legacy, perhaps through funding a private foundation or establishing a charitable trust?

It can be complicated to weave together all of these elements. But we have the tools, expertise, and experience to help you create a financial plan that feels comfortable. ●

Please remember that different types of investments involve varying degrees of risk, and there can be no assurance that the future performance of any specific investment, investment strategy, or product (including the investments and/or investment strategies recommended or undertaken by Financial Decisions, Inc.), or any non-investment related content, made reference to directly or indirectly in this newsletter will be profitable, equal any corresponding indicated historical performance level(s), be suitable for your portfolio or individual situation, or prove successful. A copy of the Financial Decisions, Inc.'s current written disclosure statement discussing our advisory services and fees is available upon request.

Straight Talk About Living Trusts

Ask two financial experts about the benefits of using a revocable living trust and you might get precisely opposite reactions, especially on a regional basis. One might say that it's the greatest thing since sliced bread, while the other could argue that it should be avoided like the plague. The truth probably lies somewhere in between.

How does a living trust work? You set up the trust, transfer assets to it, and name a trustee to handle matters. If you designate yourself as the "initial beneficiary," you're entitled to receive income from the trust for the rest of your life. At the same time, you designate "secondary beneficiaries"—perhaps your spouse, your children, or both—who will receive the remaining assets when the trust terminates.

Significantly, you can still retain some control of assets in a living trust while you're alive. For instance, depending on the trust terms, you may be able to sell assets and keep the proceeds, amend terms of the trust (for example, change secondary beneficiaries), or revoke it entirely. The assets in the trust become irrevocable upon your death.

The main advantage is that assets in a living trust are exempt from probate, a process that may be required for assets bequeathed through a will. Proponents of living trusts note that the probate process can be costly and time-consuming. Also, if you face physical or mental limitations in your old age, with a living trust, a trustee for your assets is already in place.

However, detractors point out there are less expensive ways of avoiding probate, such as acquiring property jointly with rights of survivorship (although this may not be the best option in community property states). Also, the cost and complexity of probate is often exaggerated and can vary greatly from state to state. Finally, despite a common perception to the contrary, there's no estate tax advantage to using a living trust, as you typically retain the right to revoke it. And even die-hard supporters of living trusts acknowledge you'll still need a will to tie up the loose ends of your estate.

So when does a living trust make sense? Consider these four key factors:

1. Age. Younger people in good health have less incentive to use a living trust than do retirees. Remember, a living trust will provide little benefit during your life.

2. Financial status. The more wealth you have, the more you're likely to benefit from a living trust. It will make things easier on your heirs if some or all of your assets bypass probate.

3. Marital status. If you're married and you own a house or other main assets jointly with your spouse, there's less need for a living trust. Furthermore, many states allow surviving spouses to use expedited probate procedures.

4. Confidentiality. One of the main arguments for a living trust is that your testamentary disposition remains confidential. This could be important for some families.

Don't be swayed by the hype of either point of view. We can help you make an assessment of whether a living trust is right for you. ●

The Realities Of Charity

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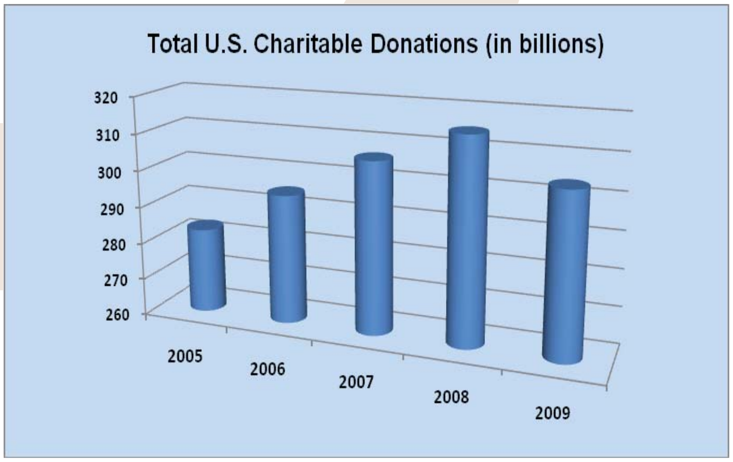
Most major charities have adopted a "Donor Bill of Rights" jointly created by several philanthropic associations. Available at Charity Navigator and other sites, the document lists 10 things you should expect from any reputable group. This includes information about the group's board, whether it uses paid solicitors to ask for donations, and a promise to treat donors with respect. These guidelines give you one more tool for taking stock of an organization you're considering.

Once you've selected a charity and made a donation, you need to make sure that you have the documentation needed to claim an income tax deduction. The Pension Protection Act of 2006 tightened the rules for substantiating monetary gifts, and you now must have a written record of any contribution. If the IRS asks, you need to be able to show a bank statement or a written communication from the charity verifying your gift. This should show the organization's name, the date of the contribution, and its amount. This requirement now applies to all monetary contributions, even small gifts given in cash.



Charities need your help now more than ever. If you understand the realities of charitable giving, you can deliver your money to deserving groups that will put your generosity to good use. ●

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