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Financial Briefs

SEPTEMBER/OCTOBER 2014

6 Rules for Deducting Charitable Contributions

88% of American households donate to charities. In 2012, individuals donated $223 billion, while foundations and corporations gave another $93 billion. Why? Mostly because they care about the organizations to which they donate, though tax deductions for charitable gifts *may* influence some people to donate, or donate more, than they would otherwise.

The IRS permits taxpayers to deduct the value of charitable contributions up to a certain limit (generally, the deduction cannot be more than 50% of your adjusted gross income, though lower limits may apply). As a deduction, qualified charitable contributions reduce the amount of income subject to tax. Here are six other rules you'll need to know if you plan to claim the charitable contribution deduction.

1. Not every donation counts as a deductible contribution. A charitable contribution, per the IRS, is "a donation or gift to, or for the use of, a qualified organization. It is voluntary and is made without getting, or expecting to get, anything of equal value." Deductible contributions include:

- Money or property you give to religious organizations; federal, state, and local governments (if your contribution is solely for public purposes); nonprofit schools and hospitals; qualified organizations like The Salvation Army, American Red Cross, CARE, Goodwill Industries, United Way, Boy Scouts of America, Girl Scouts of America, Boys and Girls Clubs of America, and others; and war veterans' groups.
- Expenses paid for a student living with you, when that student is sponsored by a qualified organization.
- Out-of-pocket expenses when you serve as a volunteer for a qualified organization.

Donations that are ***not*** considered deductible contributions include:

- Money or property you give to civic leagues, social and sports clubs, labor unions, and chambers of commerce; foreign organizations (except certain Canadian, Israeli, and Mexican charities); groups that are run for personal profit; groups whose purpose is to lobby for law changes; homeowners associations; individuals; and political groups or candidates for public office.
- The cost of raffle, bingo, or lottery tickets.
- Dues, fees, or bills paid to country clubs, lodges, fraternal orders, or similar groups.
- Tuition.
- The value of your time or services.
- The value of blood given to a blood bank.

2. Not every nonprofit is a qualified organization. The IRS rules stipulate that a charitable contribution is one given to a qualified

Continued on page 2

Tax Planning as You Age

While tax planning should be a consideration through all phases of life, the nature of that planning changes as you approach retirement age. During your working years, your primary tax planning objectives are to reduce your current income taxes while saving for retirement. After decades of accumulating money, you now need to ensure you withdraw and manage that money properly. Here are some tips:

Rolling out of a 401(k) — If you don't want to leave your funds in your 401(k) plan, you should consider transferring your money to an individual retirement account (IRA). You can now transfer directly to a Roth IRA. While there are no income tax ramifications if you

Continued on page 3

FR2014-0513-0305

6 Rules

Continued from page 1

organization, which includes nonprofit groups that are religious, charitable, educational, scientific, or literary in purpose, or that work to prevent cruelty to children or animals. Fortunately, you don't have to discern which organizations qualify from the IRS' vague definition; the IRS keeps a list of qualifying organizations at: www.irs.gov/Charities-&-Non-Profits/Search-for-Charities.

3. If you want to deduct charitable contributions, you have to itemize. The IRS gives taxpayers two options for deducting certain types of expenses from income. One option is to take the standard deduction, which in 2014 is $6,200 for most taxpayers ($12,400 for those filing jointly). The other option is to itemize deductions, which means you actually list all of those qualifying expenses and deduct them from your income. Common deductions include mortgage interest and charitable contributions.

4. You must have a record. Every time you make a contribution to a qualified organization, get a receipt. If your donation is a monetary gift, you need to keep a bank record, payroll deduction record, or a written communication from the organization containing the name of the organization, the date of the contribution, and the amount. If you donate items rather than money, the organization needs to list each item donated, its condition, and its fair market value. For donations of property valued at $500-$4,999, you must also have a record of when and how you got the property. For donations valued at more than $5,000, you will also need an official appraisal.

5. You can deduct unreimbursed out-of-pocket expenses and mileage when you're volunteering, but you can't deduct the value of your time. If you donate to charity by volunteering your time and/or talents, you can deduct out-of-pocket expenses if the organization hasn't reimbursed you. You can also deduct the cost of transportation to and from the location where you volunteered (if you drive, you can either compute actual costs or use the standard rate of 14 cents a mile). You cannot, however, deduct the value of the time you spent volunteering; nor can you deduct the expense of childcare.

6. If you receive something in return, you have to deduct its value. IRS rules define a charitable contribution as one that you make without expecting to get anything of equal value in return. However, organizations will often provide incentives for individuals to donate — meals out, tickets to a sporting event, a t-shirt, etc. If you received anything in return for your donation, you must subtract the value of what you received from the amount of your donation. For example, if you donated $100 to a qualified organization and you received a $20 t-shirt in exchange, you can only deduct $80.

Whatever motivates you to give to charity, deducting your charitable contributions can help reduce your tax liability.

Investment Tax Strategies

With marginal tax rates of up to 39.6%, taxes can seriously erode your investment's total return. Consider these strategies, which can help you reduce income taxes:

- **Consider your holding period before selling.** Gains on investments held for one year or longer are taxed at the capital gains tax rate of 15% or 20% (0% if you are in the 10% or 15% tax bracket), rather than ordinary income tax rates. Thus, before selling an investment, review your holding period.
- **Review realized gains and losses before year-end.** If you have realized gains but are holding investments with losses, you might want to sell them before year-end to offset those gains. You can offset all of your capital gains plus take an additional $3,000 of loss against ordinary income.
- **Specifically identify which shares you are selling.** If you purchased an investment over time, you may have varying basis amounts for different shares. Your gain or loss will be determined by which shares you sell. Thus, you should assess your overall tax situation, decide whether you want a higher or lower gain or loss, and then designate which shares you want to sell.
- **Donate investments with large capital gains to charitable organizations.** You can deduct the fair market value of the investment (provided you held it over one year) as a charitable contribution, subject to limitations based on your adjusted gross income. By donating the investment, you do not pay capital gains taxes on the gain.
- **Keep track of your investments' bases so you don't overpay taxes.** For instance, reinvested dividends are part of your cost basis since income taxes were paid when the dividends were received. For inherited assets, the cost basis is typically the value on the date of the previous owner's death.
- **Consider tax-deferred or tax-exempt investments.** The interest income from municipal bonds is typically exempt from federal income taxes and possibly state and local income taxes. Contributions to 401(k) plans and IRAs can grow on a tax-deferred or tax-exempt (for Roth IRAs) basis. This deferral of income taxes can make a significant difference in the ultimate size of your portfolio.

Please call if you'd like to discuss how to structure your portfolio in a more tax-efficient manner.

Tax Planning

Continued from page 1

rollover from a 401(k) plan to a traditional IRA, you do have to pay taxes on the amounts that would be taxable when withdrawn when converting to a Roth IRA (i.e., contributions and earnings in deductible IRAs and earnings in nondeductible IRAs). However, if you pay the income taxes from funds outside the IRA, you have essentially increased the value of your IRA, since you won't have to pay income taxes on qualified withdrawals.

If you own stock in your employer's company which is in your 401(k) plan, consider those assets separately. There is a provision in the tax code that may save you a substantial amount of taxes. Instead of rolling over the company stock, have the shares distributed to you and put them in a taxable account. You will owe ordinary income taxes on the cost basis of those shares, which equals the price that was paid when the stock was purchased. (If you take the distribution prior to age 59½, you may also owe the 10% federal income tax penalty on the cost basis.) At this point, you do not pay taxes on any appreciation in the stock's value. When you sell the stock, provided you have held it for at least one year, you will owe capital gains taxes at a maximum rate of 20% on the net unrealized appreciation, rather than ordinary income taxes that would be paid on other traditional IRA distributions. If you have substantial appreciation in your company stock and are in a high marginal tax bracket, this strategy can save you a substantial amount of taxes.

Handling an inherited IRA — IRAs are becoming an increasingly significant asset for many people due to 401(k) rollovers and asset growth. Thus, it is becoming more likely that you will inherit an IRA. Don't immediately cash out an inherited IRA, which requires the payment of income taxes on the distribution. If you inherit a traditional IRA from a spouse, you can delay distributions until age 70½ and then take distributions over your life expectancy. No distributions are required during your life if it is a Roth IRA. If you inherit the IRA from someone other than your spouse, you must start taking distributions in the year following the owner's death, but you can take those distributions over your life expectancy. Make sure to investigate whether you are entitled to an income in respect of a decedent deduction, which is available when federal estate taxes are paid on IRA assets. This deduction can help offset income taxes due on distributions.

Dealing with a second home — If you plan on moving after retirement, you might want to acquire a home in that location before retirement. But first, be aware of the 1031 exchange rules. These rules allow you to sell one property and purchase another of like kind, deferring any gains. For instance, this tax rule can be used to help acquire a retirement home. Start out purchasing a small investment property. You can sell it at a later date and purchase a more expensive property, deferring the gains. You can continue this process until you eventually purchase your retirement home. However, before living in the home, you must first rent it out to defer the gain. While there are no clear-cut rules on how long the home must be rented, the Internal Revenue Service has validated a two-year period. After that, you can move into your retirement home and use it as your principal residence. As long as you live in the home for two of the last five years before selling, you could then sell the home and exclude $250,000 of gain if you are single and $500,000 of gain if you are married filing jointly.

When purchasing the second home, be sure to get a mortgage on that property rather than a home-equity loan against your principal residence. Interest is only deductible on $100,000 of a home-equity loan, while the entire interest on a mortgage up to $1,000,000 would be deductible.

Selling a business — Many business owners find that their business comprises a substantial portion of their net worth. Thus, when it comes time to sell that business, they naturally want to negotiate as large a selling price as possible. But keep in mind that there are many ways to structure a sale. You might want to consider an installment sale, so the gain is recognized over a period of years rather than a single year. You may want to consider including a consulting contract for a period of years. If you are selling the business to employees, an employee stock ownership plan may make sense.

Reviewing your estate plan — As you approach retirement, it's a good time to review your entire estate plan. While the estate tax exemption is large ($5,340,000 in 2014), estate-planning strategies should still be considered. Those with large estates probably don't want to leave their entire estate to their spouse. While that will avoid estate taxes on the first spouse's death, estate taxes may be owed after the second spouse's death if the estate is larger than the estate tax exemption. While changing estate tax exemption amounts can make it more difficult to plan, you should still consider leaving part of your estate to other heirs. If you don't want to make outright distributions in case your spouse needs the assets, you can set up a trust (commonly referred to as a credit shelter or bypass trust) to hold those assets. Your spouse can then use the income and even some of the principal, with the remaining assets distributed to your heirs after his/her death. This preserves the use of your exclusion amount. You may also want to add a disclaimer provision to your estate-planning documents, detailing what happens if one of your heirs disclaims his/her inheritance. This provides a way for heirs to decide after your death how much should be placed in various trusts.

These are only a few situations to consider as you approach retirement age. Please call if you'd like to discuss your specific situation in more detail.

FR2014-0513-0305

Business Data

Indicator	Jun-14	Jul-14	Aug-14	Dec-13	Aug-13
	Month-end				
Prime rate	3.25	3.25	3.25	3.25	3.25
3-month T-bill yield	0.03	0.03	0.03	0.07	0.04
10-year T-note yield	2.63	2.53	2.41	2.89	2.86
20-year T-bond yield	3.17	3.06	2.93	3.61	3.61
Dow Jones Corp.	2.71	2.81	2.72	3.11	3.17
GDP (adj. annual rate)#	+2.60	-2.10	+4.20	+2.60	+2.50

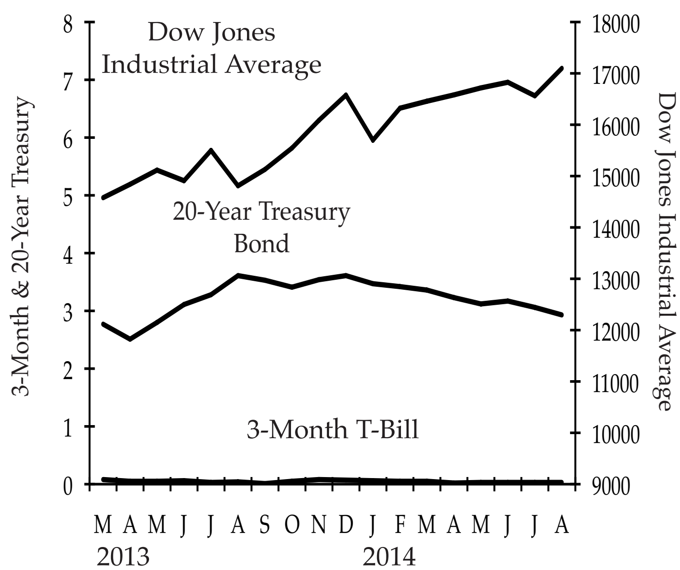
Indicator	Month-end Jun-14	Month-end Jul-14	Month-end Aug-14	% Change YTD	% Change 12-Mon
Dow Jones Industrials	16826.60	16563.30	17098.45	3.1%	15.4%
Standard & Poor's 500	1960.23	1930.67	2003.37	8.4%	22.7%
Nasdaq Composite	4408.18	4369.77	4580.27	9.7%	27.6%
Gold	1315.00	1285.25	1285.75	7.0%	-7.8%
Unemployment rate@	6.30	6.10	6.20	-11.4%	-16.2%
Consumer price index@	237.90	238.30	238.30	2.2%	2.1%
Index of leading ind.@	101.90	102.40	103.30	5.1%	8.3%

— 4th, 1st, 2nd quarter @ — May, Jun, Jul Sources: *Barron's, Wall Street Journal*

Past performance is not a guarantee of future results.

18-Month Summary of Dow Jones Industrial Average, 3-Month T-Bill & 20-Year Treasury Bond Yield

March 2013 to August 2014



News and Announcements

Caring for an Aging Parent

As life expectancies continue to increase, it becomes increasingly likely that you may need to help an aging parent financially. If you find yourself in this situation, review the tax laws to determine whether you qualify for some tax relief. The key is to determine whether you can deduct your parent as a dependent, which entitles you to an additional personal exemption on your tax return, reducing your taxable income by $3,950 in 2014. To do so, your parent's gross income can't exceed the exemption amount, and you must provide over half your parent's support. For purposes of the gross income test, Social Security benefits typically aren't considered.

What happens if you share your parent's support with your siblings or other relatives? If the combined total equals more than half your parent's support and each person contributes at least 10% toward care, you can file a multiple support declaration. Even though more than one person contributed to the support, the parent can only be claimed as a dependent by one person. The multiple support declaration form informs the Internal Revenue Service of who is declaring the dependent for the tax year. You can change the declaration on a year-to-year basis, so each person providing support receives some tax relief.

If you claim your parent as a dependent, any medical expenses paid for your parent can be claimed as a medical deduction on your tax return. Your total medical expenses, including your parent's expenses, must still exceed 7.5% of your adjusted gross income before you can take the deduction. If you aren't able to claim your parent as a dependent due solely to the gross income test, you can still include your parent's medical expenses on your tax return. When calculating these expenses, be sure to include premiums for supplemental Medicare coverage and long-term-care insurance. If your parent lives with you and you must obtain outside care to go to work, you may be able to claim the dependent care credit. Also look into whether your employer offers a flexible spending account for elder care. This may allow you to set aside pretax dollars to pay eldercare expenses for a dependent parent.

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