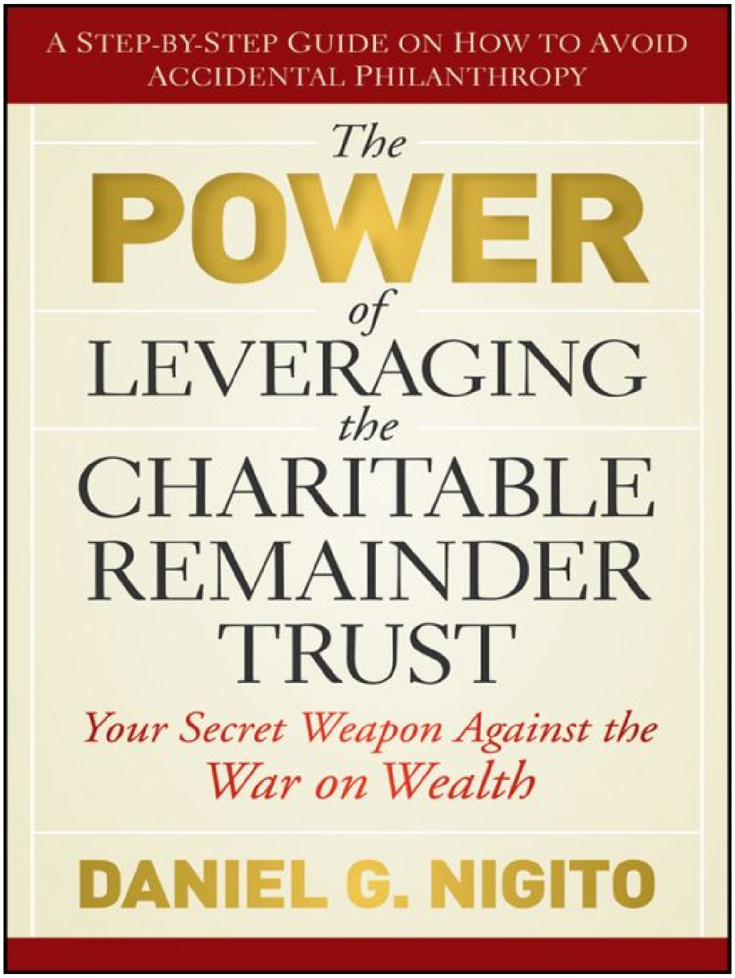
A STEP-BY-STEP GUIDE ON HOW TO AVOID ACCIDENTAL PHILANTHROPY

The POWER of LEVERAGING the CHARITABLE REMAINDER TRUST

Your Secret Weapon Against the War on Wealth

DANIEL G. NIGITO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For my wife, Shelley. Just being in your presence elevates my game.

Acknowledgments

No one can whistle a symphony. It takes a whole orchestra to play it.

—H.E. Luccock

I have been blessed in my life to be supported along the way by people who allow me to do the “job” that I love—teaching folks how to add meaning to their money. I want to mention a few of them here. At the heart of our team at Market Street Financial Advisors, in Bethlehem Pa is David Weikert. Dave handles all the day to day “stuff” that keeps our business running, while I’m off writing books and giving lectures. He’s been with me for over ten years and I could not do what I do without him.

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the best business sense of anyone I know. Her impact on our community through her leadership as the CEO of the State Theatre, Center of the Arts in Easton, Pa is the stuff legacies are built on. She set the standard for integrity.

Finally, I must thank our kids—in order of their appearance, Courtney, Tim, Natalie, Dominic, and Vince. They range in age from 30ish to 20ish and I have cherished every single year. I love my family (even our bulldog, Gracie), and I can’t put it any simpler than that. I thank God for them every day. Speaking of God, this book may be mine, but the glory is His.

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INTRODUCTION

Is this the Change You Can Believe In?

If you put the federal government in charge of the Sahara Desert, in five years there'd be a shortage of sand.

—Milton Friedman

Well, here we are. Just about everything we earned over the last 12 years is gone. But it is not enough. If you played by the rules, paid your taxes, paid your bills (mortgage, too), put a few dollars away, and invested in the United States—or the world for that matter, you lost. We lost. But it is not enough. The revolution came and went, without a shot fired, without blood spilled. We are now ruled by a congress and president determined to redistribute the wealth at all costs—even if it costs all. America, this is your wake-up call: *This is not a congress or administration that cares about getting it right, it is about getting even.*

In a nutshell, your government feels that they can spend your money better than you can, that they can *manage* your money better than you can. They determine who gets what and how much; which causes are worthwhile and which are not. And, they do it with *your* money. But, not to worry, they can be trusted to be the stewards of your tax dollars, right? How's that been working out so far?

This book is about one simple strategy that we can use to help us take back control of our money and how it's spent. There are many strategies—this is only one, *but it is effective.* It's about wiping the blood from our collective nose, taking the standing eight-count, and staggering back into the ring. Okay, maybe I'm getting a little carried away with the athletic analogies—but you get my point, *fight back*!

Wake Up and Smell the Reality

- If you earn more than $150,000 per year (not the $250,000 you've heard about), you're the enemy.
- If someday you plan on taking more than $150,000 out of your retirement plan, or plan on transferring what's left of it to your kids when you die, you're the enemy.
- If you own your own business—even if you're the only employee—you're the enemy.
- If you own any investment that will someday be sold for a gain (which is the whole point), you're the enemy. I know that seems like a reach after the market beat-down, but gains do still exist and will return.
- And if you spent your life building your assets to where they exceed $3,500,000, you are really the enemy.

Notice that nowhere in the list above did I mention Wall Street moguls making $20 million bonuses. Nowhere above did I mention the "titans" of industry who amassed vast amounts of wealth while running their companies into the ground. This book is not about them, it is about us. They make great headlines and make us furious. But they are thieves and thugs, they are not us. Unfortunately, they have provided a great excuse for the current administration to wage a war on wealth and on those who actually believe in capitalism and the creation of wealth. What used to be called "the American dream."

Look in the mirror, look at you paycheck, look at your assets—that's us, you are us. We are the 10 percent who pay 71 percent of all the income taxes. We are the 5 percent who pay 89 percent of all the capital gains taxes. We are the 2 percent that pay 100 percent of all the gift and estate taxes. We are a targeted class of *accidental philanthropists.* That is, we don't have the choice of who we give our money to, or how much we give them. The government takes, the government decides—who and how much.

Until now.

There is a way to fight back. There is a way to take control of your tax dollars and how they are spent. The best way to avoid the redistribution of wealth through taxation is by avoiding the taxation in the first place—legally. The best way to avoid becoming an accidental philanthropist is by becoming an *active* one by using the specific strategy detailed in this book. *The best way to fight back is by unleashing the power of charitable leverage.*

Stay with me and I will teach you this strategy in words of one syllable or less. I'll use plain New Jersey English and lots of step-by-step charts. Stay with me and I will show you the real magic of this strategy, that when you use charitable leverage you take the power away from congress and keep it for yourself. Better still, in the process you will provide more wealth for you and your family.

It's your money. Shouldn't you be the one to decide what happens to it?

The Power of Charitable Leverage

We have the right as individuals to give away as much of our own money as we please in charity; but as members of Congress we have no right to appropriate a dollar of the public money.

—Davy Crockett

Before we go any further, I want to be very clear on this strategy I call *charitable leverage.* I want you to become a philanthropist instead of a dope. Is that clear enough? The current state of our tax system penalizes those among us who work the hardest, take the risks, and actually buy into capitalism and free markets. And it is going to get worse. The key to a charitably leveraged plan is that *dollars you would normally lose to taxes are rerouted to causes you actually care about—to be used exactly the way you want.*

Throughout the nonprofit world a battle has raged forever among development officers and professional fundraisers about the role tax incentives play in charitable giving. This strategy takes place outside of that debate. The use of a charitably leveraged strategy is not about whether you have it in your heart to give, but whether you have it in your stomach to let the government give it for you.

Charitable leverage offers a new type of wealth management—one that allows you to become a *partner with charity* to gain control over your tax destiny and to provide for you and your family in the bargain. In short, it allows you to add meaning to your money. This is not about some new tax loophole I discovered. It is completely the opposite. This strategy uses two financial instruments that are rooted in the tax code and have been hiding in front of us for decades.

This may not be the right approach for you. For you to fully benefit from the programs I present in this book, you first must fit into one of the accidental philanthropist targeted categories that we cover in the next chapter; and *you do need to have a desire to create a charitable legacy.*

So here's how we're going to do this.

- First, I show you how you are exposed to accidental philanthropy by virtue of the current tax structure and redistribution of wealth.
- Next, I explain the mechanics of charitable leverage. I break it down so that you see clearly how it works. There are only two moving parts so it's pretty simple to understand.
- When, we're done with that, I show you how you can apply a charitably leveraged strategy in specific everyday financial planning scenarios.
- Finally, I follow each planning strategy with a case study that plugs in real numbers and then compares it with its traditional and "accidentally philanthropic" alternative.

When we're done you'll be in a position to judge for yourself whether this is the right plan for you. Imagine that, you—in control—of your money.

PART I

WELCOME TO THE WAR ON WEALTH

CHAPTER 1

The Weapons of Mass Destruction in the War on Wealth

> *Government's view of the economy could be summed up in a few short phrases: If it moves, tax it. If it keeps moving, regulate it. And if it stops moving, subsidize it.*
>
> *—Ronald Reagan*

Taxes are the weapons of choice used by the government in its War on Wealth. Income tax, dividend tax, capital gains tax, estate tax, and income tax again on retirement plans are the new WMD. They may not be Weapons of Mass Destruction, but they are Weapons of Mass re-Distribution. Further, it impacts a hell of a lot more than 5 percent of U.S. taxpayers. *You are the target.*

This chapter poses a simple question, "Just how many times can you tax the same damn dollar?" I tell you in advance that you're not going to like the answer, but you need to know what you're up against. We work under the brunt of a tax system that can impose different types of tax on the same dollar up to *three or four separate times.* With every tax dollar you pay you move farther along the road to accidental philanthropy. Let's take a look at each tax, when it is applied, and just who pays it. If you have any antidepressants or antacids lying around the house, you may want to take them *all* now. Put the laxatives away—you're not going to need 'em.

Tax #1: The Federal Income Tax—Negative Impact 28 Percent to 35 Percent. Going to 36 Percent to 40 Percent

Before I get into what the income tax rate is now and what it will be when the Bush tax cuts expire in 2011 (as proposed under President Obama's budget), let's take a look at who *actually pays this tax* and how much we pay.

Table 1.1 shows that, according to the latest IRS statistics (based on 2006 Adjusted Gross Income, AGI), the top 5 percent of the highest earning Americans, pay more than 60 percent of all the income taxes paid. But here is the stunning part of that statistic—to be in that category you only need income over $153,000! To be in the top 10 percent, who pay 71 percent of all the taxes, your earnings only need to exceed, $108,000. If you want to be in the rare air of the 1 percent who pays 40 percent of all the income taxes, you only need adjusted gross income greater than $389,000. The bottom 50 percent pays less than 3 percent of the tax burden.

The takeaway from Table 1.1 is that while everyone seems focused on the evil top wage earner making more than $250,000 per year, the reality is that if you're earning more than $150,000 you're bearing the brunt of taxes as well. How much are we talking about? Take a look at Table 1.2.

We may not like it, but it is the simplest to understand. For every new dollar we earn, we give away currently 33 cents to 35 cents. When the Bush tax cuts expire at the end of 2010, that number increases to 36 cents to 40 cents. Not great, but if that was the only time that dollar was taxed I don’t think many of us would complain. I’m not saying we’d be throwing a party, but we wouldn’t be miserable either. The problem is that if you play by the rules and save some of your money instead of spending it all, the government repays you by continually taxing that same dollar. How? Read on.

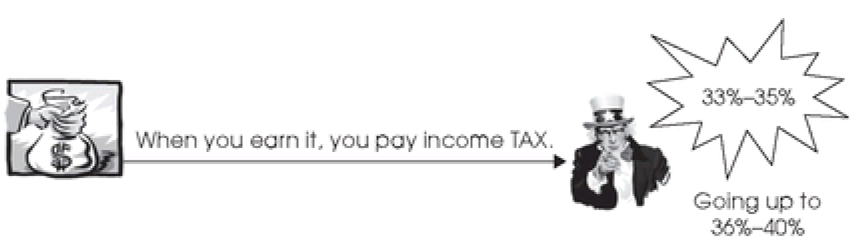
Table 1.1 Income Taxes Paid by Catagory

Source: IRS Statistics via Kiplinger.com, July 25, 2008, “What’s Your Share of the Nation’s Tax Bill?” by Kevin McCormally.

Percentage Ranked by AGI	AGI Threshold on Percentages	Percentage of Federal Income Tax Paid
Top 1%	$388,806	39.89
Top 5%	$153,542	60.14
Top 10%	$108,904	70.79
Top 25%	$64,702	86.27
Top 50%	$31,987	97.01
Bottom 50%	<$31,987	2.99

Table 1.2 Current and Proposed Income Tax Rates.

2009 Tax Bracket	AGI Range for Married Couples	AGI Range for Singles	Proposed Increase in 2011
28%	$137,050–$208,850	$82,850–$171,550	28%
33%	$208,850–$372,950	$171,550–$372,950	36%
35%	<$372,950	<$372,950	39.6%



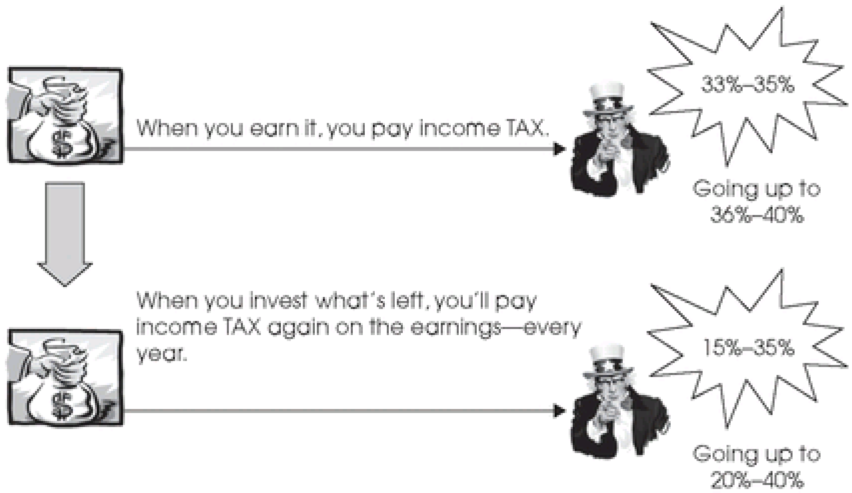
Tax #2: Investment Income Tax—Negative Impact: 15 Percent to 35 Percent. Going up to 20 Percent to 40 Percent

After you have paid income tax on your earnings, you have a choice as to what to do with what's left. You can spend it, you can save it, or you can do a combination. Remember, we're talking about your after-tax earnings, not your 401(k), or other pretax retirement plan (we cover those later). You probably spend some, save some in an effort to accumulate a nest egg for whatever the future holds. You would think that a country with one of lowest savings rates in world would provide an incentive to save, we don't. In fact, we do the opposite; we tax the crap out it.

If you invest that after-tax dollar into corporate America (you know, the stuff capitalists do to make money and help the country grow) you'll pay a tax on your earnings. If you buy corporate bonds the annual bond income is taxed at your ordinary income tax rate. If you buy a stock that pays a dividend, you'll pay tax at the current dividend tax rate of 15 percent. Both rates are scheduled to increase under the proposed budget.

If you choose to invest some of your savings into other programs like real estate or more exotic funds, you will not escape an additional tax on your investment earnings. Municipal bonds are the only income-producing investment that is tax-free. Have you looked at those returns lately?

There's no need to beat this to death, I have far more disturbing stuff to get to. I just want you to be aware of tax #2. A lot of people skip over it like it's not a big deal. It is.



Tax #3: Capital Gains Tax—Negative Impact: 15 Percent Going to 20 Percent

In my view there is nothing quite as harmful as the tax on capital gains. It is a pure penalty imposed on the capitalist for investing in something that works. For the U.S. business owner, it is the ultimate slap in the face for his or her success. It is like the government saying, “Our way of thanking you for building this country is to tax you on the profits you made on the money we’ve already taxed, after taxing you on all the income that you produced.” Does that make any sense to you, or is it just me?

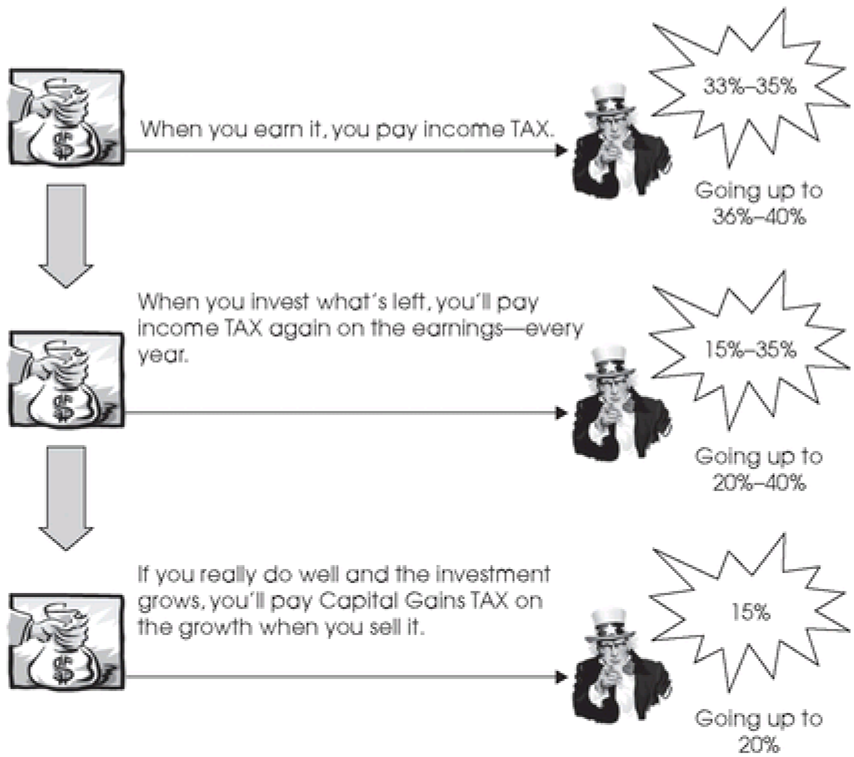
Like the federal income tax, the sweet spot for capital gains tax is the top 5 percent of income earners. People earning more than $154,000 per year account for 89 percent of all the capital gains tax paid! That is a stunning number. Even more stunning is the fact that the tax rate, currently 15 percent will increase under the proposed budget to 20 percent in 2011. That ought to stimulate the economy, right? Table 1.3 shows the stats on who pays the capital gains tax. For example, if you are a taxpayer in the top 10 percent of wage earners, your group accounts for more than 94 percent of all the capital gains taxes.

So, if you're keeping score, first you pay 40 percent tax on the income you earn. Then, you take some of that remaining income and invest it for the future, and you pay 20 percent to 40 percent on the income that it generates each year. Then, if you're lucky enough to invest in something that appreciates in value over time, you pay tax again when you sell it; to the tune of another 20 percent! And, that's just the injury; we haven't gotten to the insults yet.

Table 1.3 Who Pays Capital Gains Tax?

Source: IRS Statistics of Income, 2006; Institute on Taxation and Economic Policy, March 2006.

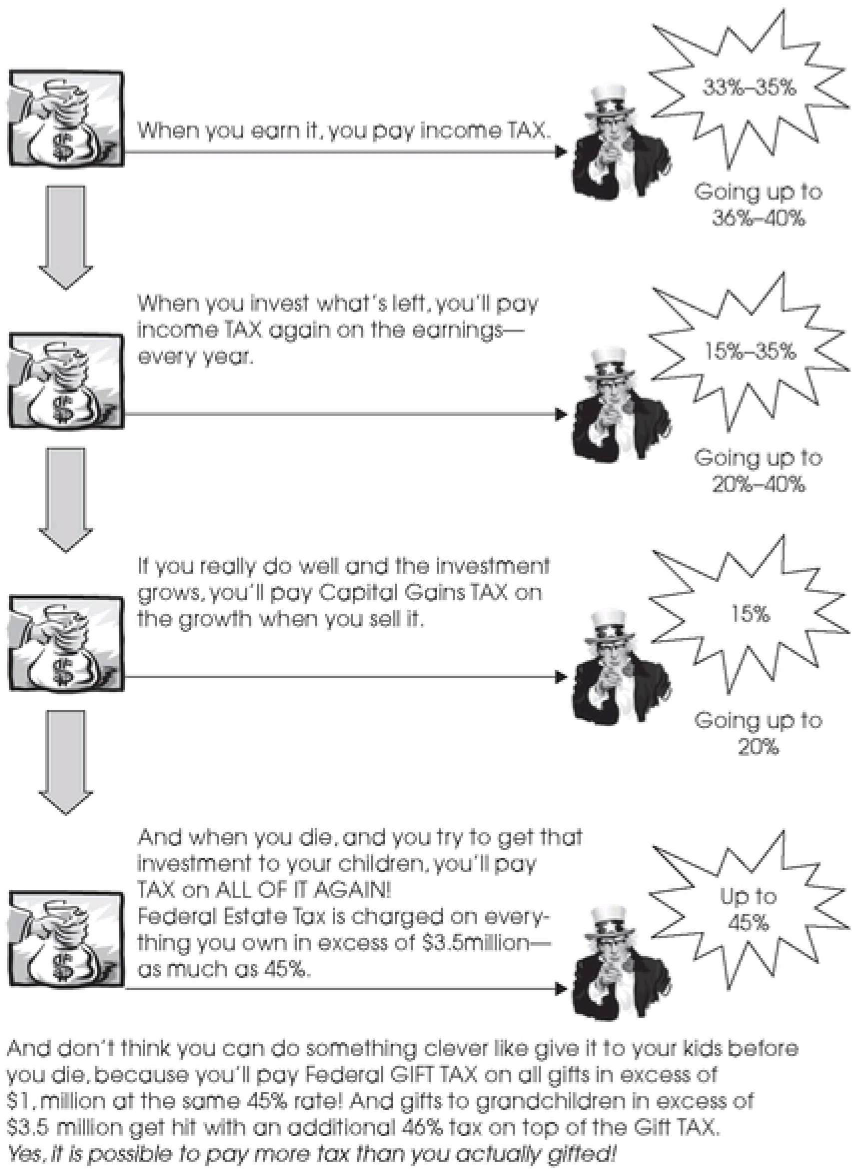
Percentage Ranked by AGI	AGI Range in Dollars	Percentage of Capital Gains Tax Paid in Range
Top 1%	>$396,000	72.6%
Top 5%	$154,000–$396,000	16.9%
Top 10%	$110,000–$154,000	4.8%
Top 20%	$77,000–$110,000	3.2%
Bottom 80%	<$77,000	2.5%



Tax #4: Federal Estate Tax—Negative Impact: 45 Percent on Transfers at Death Over $3,500,000

And then, you die. Imagine that after paying tax all along the way during your life, you get one more parting shot when you die and try to transfer what's left to your kids. The message behind this tax is very clear; it is redistribution of the wealth in its purest form. It is the government standing between you and your children. It is that simple.

Federal estate tax impacts less than 2 percent of Americans each year, but accounts for more than $22 billion in tax revenue. We all receive a tax credit on the transfer up to $3,500,000 at death. Estate tax kicks in after that to the tune of 45 percent. Here's the part you need to understand. Unlike the other three taxes you pay along the way, the federal estate tax is not a tax on new income or new growth. It is not a tax related to cash flow at all. *It is a tax on all your stuff* !



Everything, your house, your car, your rugs, your collectibles, your jewelry, your investments, your *retirement plan* (I get into more detail on that in a minute), your business, your investment real estate, your insurance, your furniture, everything you own is subject to estate tax. Even stuff you inherited from other family members—that you already paid tax on—is subject to tax.

And here’s the cruelest rub of all, though your assets are valued at current market prices, even if they are illiquid, the government wants cash—in nine months. Can you imagine forcing a sale of a home in the current real estate market? Do you think you’d get what the home is worth, especially if the buyers knew there was a government clock ticking?

Estate taxes can be devastating because it sucks out all of the cash first, and leaves the family with illiquid assets. The net result to the family can be far worse than the 45 percent price tag.

Don’t think that you can fool the IRS by gifting your assets to your children before you die. You can’t beat ‘em, in fact the tax could be worse. The gift tax rates are the same as the estate tax rates with one major difference, the free pass ($3,500,000 at death) is only $1,000,000 for gifts. Skip the kids and go directly to the grandkids and you face an *additional* generation-skipping transfer tax of 46 percent on transfers more than $3,500,000.

But Wait, There’s One More Tax

Do you have any idea what happens to your IRA when you die? You better grab a bucket; you’re going to need it.

The war on wealth takes place on many fronts; the bloodiest of these is the battle over control of the destiny of your retirement plan. Retirement plans come in many types: IRA, 401(k), SEP, SIMPLE, TSA, or 403(b). They are lumped together as “qualified retirement plans.” To keep things simple I refer to all qualified plans as IRAs. They are savings vehicles that the government allows you to fund on a