*This Publication Brought to You Courtesy of:*
**LAURENCE M. SOBIN, CLU®, ChFC®**
**Sobin Financial Group**
2100 Rachel Terrace, Suite 15
Pine Brook, NJ 07058-9329
Tel: (973) 276-9235
Fax: (973) 276-9234
Email: service@sobinfinancial.com
Web: www.sobinfinancial.com



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# Private Foundations—An Alternative to Charitable Giving

For many individuals with accumulated wealth, occasional gifts to a favorite charity may satisfy their charitable inclinations. The added incentive of an often-substantial tax deduction, coupled with various estate planning benefits, can be the driving force behind such charitable gifts. However, for some individuals, philanthropy is a far more serious endeavor, often involving a *succession* of substantial gifts of at least $5 to $10 million, which may necessitate an amount of control and general oversight. In these situations, a **private foundation** can be an ideal venue for managing a large, ongoing charitable giving program.

### The Basics

In its simplest form, a private foundation is a charitable, grant-making organization that is privately funded and controlled. When properly arranged and operated, a private foundation can be an entity that is exempt from income taxes and which thereby permits tax deductions for those who donate to the foundation.

Contributions to a private foundation are deductible for gift and estate tax purposes. However, the income tax deduction for gifts to a private foundation is a bit more complex. Generally, the deduction is based on the fair market value of the gift (at the time it was

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# Tax Breaks for Elder Care

Like many Americans, you may find yourself having to help cover the medical costs and caregiving expenses of an aging parent or other close relative. If you and your parent meet certain criteria set by the Internal Revenue Service (IRS), you may qualify for tax breaks that can ease the financial burden of paying for care, even if your parent does not live in your home.

For example, your mother must not have earned or received more than the exemption amount for the tax year to qualify as a dependent. Filing in 2015 for the tax year 2014, your mother's gross income for the year has to be less than $3,950. Gross income is all income in the form of money, property, and services that is not exempt from tax. Generally, Social Security income is not counted in this amount, but there are exceptions. If, for example, your mother has other income from interest or dividends, a portion of her Social Security may also be taxable.

To be considered a dependent for tax purposes, your mother must receive more than half of her support from you. You can determine whether you have provided more than half of your mother's total support by comparing the amount you contributed to her support with the entire amount of support she received from all sources. If your mother is in her own house or in an assisted living facility or a nursing home, amounts you pay for her

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## Private Foundations—An Alternative to Charitable Giving

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given), and it is limited by the donor's **adjusted gross income (AGI)**. The charitable deduction is also limited (to 20%, 30%, or 50% of AGI) by the type of charitable organization that is ultimately receiving the gift from the private foundation *and* the type of gift being made. Gifts that are not cash or publicly traded securities, and that are valued at more than $5,000, need to adhere to specific rules to ensure that they are tax deductible.

In addition to offering the advantages of a tax deduction (which is usually not exclusive to private foundations), private foundations may also offer an array of other benefits. Because a private foundation is typically established to manage a long-term charitable gifting program, it may highlight the philanthropic presence and identity of the donor within the community or associate the donor with a particular charitable cause. It can also serve to create a family charitable legacy while at the same time protecting individual family members from the pressures of other charitable appeals. Finally, a private foundation can serve as an appropriate mechanism for controlling distributions to charities, and it can determine which charities it will benefit.

### The Technicalities

When a private foundation is established, two important questions need to be asked. First, what type of private foundation should the donor establish? And second, how should the private foundation be structured? There are generally three types of private foundations: **nonoperating**, **operating**, and **company-sponsored**. Each type of foundation has specific characteristics that make it appropriate for a particular situation. Also, each type of foundation must adhere to a set of strict requirements and guidelines.

The most common type of foundation is the *non operating*. Essentially, a donor or group of donors make contributions to the foundation, which in turn makes grants to a charity. In this case, the donor does not participate directly in any charitable work. There are several variations on this type of foundation.

An *operating* foundation may have direct involvement in charitable causes (e.g., an inner-city youth center) while retaining the tax benefits of a "private" foundation (in some respects, operating as a "public" charity does). To qualify as an operating foundation, several requirements need to be met.

A *company-sponsored* foundation is useful when the majority of contributions are from a for-profit corporate donor. Typically, the operation of this type of foundation is similar to that of a nonoperating foundation. It is usually managed by corporate officers, and it has the added benefit of allowing some contributions to accumulate over time. This can help the foundation make continual grants when corporate profits are low.

After careful thought is given to the type of foundation to be established, a decision about structure must be made. A foundation can be structured three ways; it can be a **nonprofit corporation**, a **trust**, or an **unincorporated association**.

A number of factors need to be considered to determine which structure is best. Generally, if the donor intends to keep the foundation in existence permanently, a nonprofit corporation or a trust may be the better choice. But it is important to consider a number of factors, including state and local laws governing private foundations, the type of foundation, the type of donor, the need or desire to make future changes or delegate responsibilities, and personal liability issues.

### The Cost

Creating and maintaining a private foundation is much more involved than using more traditional charitable-giving vehicles (e.g., a charitable remainder trust). Therefore, legal and accounting professionals who have experience with private foundations must play a significant role in such an endeavor. And it is important to know that expenses are likely to be substantial because of the complexity of foundations, the need for highly specialized legal and tax expertise, and the costs associated with design, set-up, management, and grant administration. Typically, a private foundation is only viable for individuals who intend to make periodic gifts in excess of $5 million.

Certainly, the private foundation allows today's philanthropist the opportunity to manage substantial charitable gifts and to actually become involved in charitable work if he or she so chooses. It also affords the donor the opportunity to be recognized for charitable giving, while solidifying his or her philanthropic legacy. As with all advanced estate and tax planning, consult with your team of qualified legal, estate, and tax professionals to help ensure that you meet the goals and objectives of all involved parties. $

# An Introduction to Split-Dollar Life Insurance

Contrary to what you may think, split-dollar life insurance is not an insurance policy, at least not in the classic sense. It is a type of arrangement that allows two parties, typically an employer and an employee, to split life insurance protection costs and benefits. The premium payments, rights of ownership, and proceeds payable on the death of the insured are often split between the company and a key employee. In many situations, however, the employer pays all or a greater part of the premiums in exchange for an interest in the policy's **cash value** and **death benefit**. Cash values accumulate, providing repayment security for the employer, who is paying the majority of the premium. In this scenario, business owners have the opportunity to provide an executive with life insurance benefits at a low cost. Another option for companies to consider is to use split-dollar policies in place of insurance-funded **nonqualified deferred compensation plans**.

The split-dollar arrangement is attractive to employers because it provides a way to recruit and retain top performers. In turn, employees have the opportunity to acquire future protection with a flexible policy that meets their needs. In addition, this type of policy can be used as a viable strategy for transferring wealth between a parent and child and for estate planning.

There are two basic types of split-dollar life insurance policies: **endorsement,** in which the employer owns the policy and reaps the benefits, but the employee chooses the beneficiary or beneficiaries and how the death benefit is paid out; and **collateral**, in which the employee owns the policy. In this situation, the employer's premium payments are treated the same as interest-free loans. The employee assigns the policy to the employer as collateral for these loans. On the employee's death, the loans are paid from the face value of the policy. Any proceeds that remain are paid to the beneficiary or beneficiaries.

### The Way It Was

Split-dollar arrangements date back to the 1930s. Over time, the Internal Revenue Service (IRS) came to view any gain or equity from a split-dollar policy, known as **equity collateral assignment split dollar**, as an interest-free loan and therefore taxable. The IRS regarded equity benefits as being profitable mainly for the party paying the lowest amount of the premium cost, and it introduced new regulations, to seek more overall transparency.

In 2003, the IRS finalized the new regulations on split-dollar policies, which are still in effect today. While validating the use of split-dollar policies in estate planning between donors and donees, the changes have curbed the use of equity collateral assignment split dollar for funding nonqualified executive compensation.

### Variations on a Theme

The following two tax regimes emerged from the 2003 IRS regulations; they affect the structure of a split-dollar policy for business owners and estate plans and depend on who owns the policy:

1. An **economic benefit** (or **equity) regime** allows the business owner/employer or the donor to pay the annual premium as the owner of the insurance policy. Alternatively, an **irrevocable life insurance trust (ILIT)** can be the policy owner, in which case the gift of an economic benefit is made annually to the trust.

   If an employer owns the policy, the employer's premium payments would provide equity or economic benefits that are taxable each year. The employee is responsible for the taxes. Benefits could include, among others, an interest in the policy cash value or the cost of life insurance protection.

2. In a **loan regime** business arrangement, if the employee owns the policy, the employer's premium payments are considered loans to the employee. In this case, the employee would be taxed on the difference between the actual interest amount and the amount that would have accrued at the market interest rate.

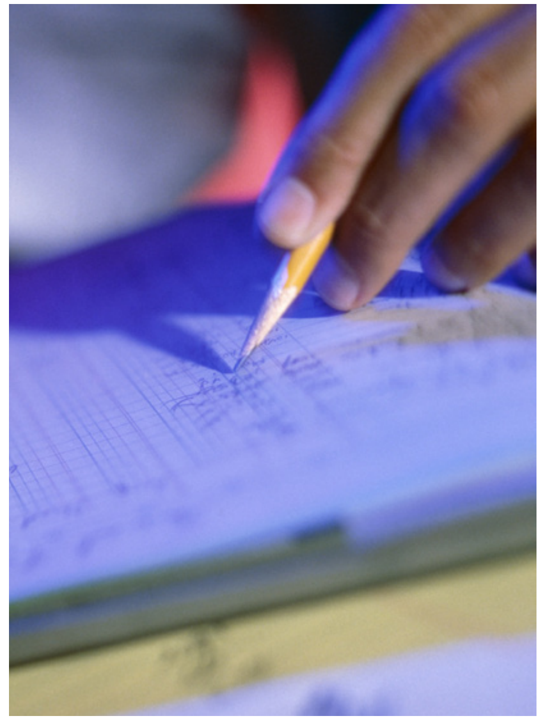
### Look Before You Leap

It is important to note that a split-dollar life insurance arrangement requires specific adherence to complex tax rules and regulations. Before establishing the policy, be sure to consult with your team of qualified insurance, legal, and tax professionals to determine how split-dollar life insurance may benefit you, your company, and your key employees. $

# Financial Recordkeeping for Tax Purposes

Keeping thorough and accurate financial records is one of the less exciting tasks that business owners face, but it is a necessary one. In addition to enabling you to monitor the progress of your business and make informed decisions on a daily basis, keeping good accounting records is essential when it comes time to prepare your tax returns. While the smallest businesses may be able to get by with the "shoebox method," having in place a reliable and comprehensive financial recordkeeping system is crucial if you want your business to grow.

The types of accounting records you must keep are not mandated by law, but the Internal Revenue Service (IRS) demands that your recordkeeping system clearly shows your business' income and expenses. A failure to keep good financial records could result in underpayment or overpayment of taxes, penalties for filing late or for underpayment, and additional fees for tax preparation. Incomplete records can also present problems if your return is audited by the IRS.



Rather than relying on handwritten journals or ledgers, many businesses now use small business accounting software to keep track of their revenues and expenses. Relatively easy to use and generally affordable, a basic accounting software application will help you generate balance sheets, categorize transactions, track sales, record cash disbursements, manage payroll, create invoices, set up budgets, conduct your banking, and monitor tax liabilities. Your tax professional may be able to recommend an accounting software program that provides the level of functionality appropriate for your business.

But even the best electronic bookkeeping system does not eliminate the need for filing and storing paper receipts that may be necessary to substantiate deductions. In addition to recording transactions electronically, keep any printed documents that show the amounts and sources of gross income, such as invoices, cash register tapes, and credit card charge slips. The IRS may also want to see documents that show the amounts paid for purchases, such as canceled checks, credit card sales slips, and invoices.

It is especially important to have a paper trail when claiming deductions for certain types of expenses, such as business-related gifts, entertainment, travel, and meal expenses. In addition to keeping paper receipts, maintain a diary or calendar to record details of business meetings, including who was in attendance and what was discussed. While you are not required to keep receipts for entertainment and meal expenses of less than $75, you should still maintain written records of any meetings for which expenses are deducted. If you use your personal car for business part of the time, keep a log in the car that records mileage, tolls, and parking fees incurred in the course of business usage.

Documents relating to the purchase price of any assets owned by the business should be securely stored, as these will be needed to determine gain or loss when the assets are sold or to compute annual depreciation. Businesses with employees have additional obligations to keep track of all employment taxes, employee Social Security numbers, and W-4 certificates, as well as a history of wages and benefits paid.

When a business-related transaction is conducted online, you may want to print out a record of the transaction and keep it on file. If you choose to store this data electronically, make sure backup copies of all important information are made and stored in a secure location.

Setting up a financial recordkeeping system for tax purposes may, at least initially, demand some extra effort on your part. But, in addition to maximizing your opportunities for deducting business expenses, getting into the habit of maintaining thorough and accurate accounting records can help you run your business more efficiently and make it easier to obtain additional financing when needed. $

# To Lease or Buy: Understanding the Basics

As leasing continues to grow in popularity, many new car buyers wonder how the option of leasing compares to buying. Let's look at a hypothetical couple, Peggy and Stan, who have always purchased their vehicles. After hearing friends and relatives tout the benefits of leasing, they now wonder whether it is better to lease or buy.

As Stan and Peggy begin to look into the leasing process, understanding the details seems overwhelming. But, as they soon discover, the basics are pretty simple. If they purchase a vehicle, they own it. If they lease a vehicle, they pay to use it, usually for two to three years, and then return the car at the end of the contract.

## Pros and Cons of Leasing

One of the main advantages of leasing is that it generally allows Stan and Peggy to get more "vehicle" for the money. Since they are only paying a portion of the total value, they can expect to make a smaller monthly payment for a given vehicle or drive a more expensive make or model for a given monthly payment. Suppose, for example, they are considering purchasing a mid-size sedan. For the same monthly payment, they may be able to lease a high-end luxury sedan. Alternatively, if they prefer the mid-size model, they may be able to pay less per month with a lease than if they purchased it.

Yet, leasing is not for everyone, and there are tradeoffs to consider. Leases include many charges that may require large sums of cash at the beginning and end of the lease. Up-front costs may include a security deposit, a destination fee, and a registration fee. Lease-end charges may be assessed for "excessive wear and tear," excess mileage (which may be up to $.25 or more per mile), and a disposition fee. If Stan and Peggy were to end the lease early, they may be expected to pay a high penalty. In addition, if they decided to purchase the car at the end of the lease, it may cost more than if they had originally purchased and financed it.

## When Buying Is a Better Option

Buying may be a better choice if Stan and Peggy plan to keep the vehicle for a long time. Usually, if the financing costs over the life of a car loan are tallied and compared to the costs of leasing and then purchasing the leased vehicle, buying makes more economic sense. Also, once Stan and Peggy own the car, they are free to drive it for years without a car payment, pass it on to a family member, or sell it. They may also maintain the vehicle as they wish, modify or customize it in any way they choose, and put unlimited miles on it without penalty.

Now that Stan and Peggy understand the basics, they are in a better position to decide between leasing and buying. They can weigh the pros and cons carefully, taking into account both their short- and long-term objectives, as well as their driving habits. Though the lease process may at first seem daunting, understanding their options can help them get the best new car deal for their circumstances. $

# You've Graduated: Now It's Payback Time

It takes four years, on average, to graduate from most colleges and universities. During that time, students can accumulate a large amount of debt. For most, the degree is worth the burden of paying off student loans long after graduation. However, these questions remain: How should the debt be repaid? Are there any plans that can help make "payback" easier? What if a student can't find a job right away?

There are plans available that offer flexible payment schedules. Students applying for a Federal student loan can choose a **graduated repayment plan** that will allow them to make smaller payments upon graduation, and larger payments when they are earning more money in the workplace.

Students also have the choice of an **income-contingent repayment plan**. This plan requires them to pay a fixed percentage of their post-graduate income toward their student loan. This percentage could be approximately 5% to 10% of anything above the poverty level of a single person, which is $11,670, according to the Department of Health and Human Services poverty guidelines (HHS, 2014).

A third choice is an **extended repayment plan** that offers monthly payments and allows graduates to extend their loan payment schedules from 10 to 15, or even 20, years.

Deferment or forbearance may also be a temporary option for graduates in a financial bind due to unemployment or other extreme hardship. In select situations, borrowers may qualify for other repayment alternatives through their loan servicers.

### Consolidation Offers Flexibility

For students who already carry a substantial amount of debt, existing loans can be *consolidated* with a direct loan from the government under the Student Loan Reform Act of 1993. This plan offers a more flexible repayment schedule while interest rates remain the same.

To be eligible for this plan, student loan recipients need to ask their original lender for an "income sensitive" repayment option. The plan adjusts the monthly payments for the loan's capital, but not the interest, to annual income. If the original lender will not agree to this option, the student may then be eligible for a direct loan from the government.

Two advantages of a direct government loan are as follows: First, the monthly installment payments of principal and interest are contingent upon income. Because the payments are withdrawn from wages, there's less paperwork. Second, as wages increase, the percentage withdrawn from pay will also increase, allowing the loan to be paid off more quickly and with less accrued interest.

For students who need to borrow for the current school year, direct loans (and the income-adjusted repayment plan) are also available if they're attending one of the schools participating in this plan. Parents may also be able to obtain a Direct PLUS loan for up to the entire cost of their children's college education.

For more information, contact the Federal Student Aid Information Center at 800-433-3243, or visit online at www.studentaid.ed.gov. $

# Assigning Your Life Insurance Policy

Getting approval for a loan can sometimes depend on, for example, a lender asking a borrower, "How will this loan be repaid in the event of your death?" Your answer may be to **assign** your **life insurance** policy, a useful feature that can help provide necessary security for a lender.

You can freely assign your life insurance policy unless some limitation is specified in your contract (your insurance company can furnish the required assignment forms). Through an assignment, you can transfer your rights to all or a portion of the policy proceeds to an **assignee**. The extent to which these rights are transferable depends on the assignment provisions in the policy, the intention of the parties as expressed in the assignment form, and the actual circumstances of the assignment.

## Types of Assignments

There are two types of conventional insurance policy assignments:

1. An **absolute assignment** is typically intended to transfer all your interests, rights and ownership in the policy to an assignee. When the transaction is completed, you have no further financial interest in the policy.

The terminology of absolute assignments differs from contract to contract. It may state that you transfer all rights, title, and interest in the policy to the assignee. Some insurance companies use an "ownership clause" to accomplish this transfer.

2. A **collateral assignment** is a more limited type of transfer. It is a security arrangement to protect the assignee (lender) by using the policy as security for repayment. After the debt is repaid, the assignee releases his or her interest in the policy, and all rights to the policy revert to the owner.

Under the usual procedure, if the collateral assignment is still in force at the time of your death, the assignee informs the insurance company of the remaining debt, including interest, and receives that amount in a lump sum. Any excess proceeds are then payable to your named **beneficiary** in accordance with the beneficiary designation in your policy.

To fully protect the assignee, notice must be given to the life insurance company that the assignment has been made. If a company without notice of assignment pays the proceeds to another assignee or to a named beneficiary, the insurance company cannot be forced to pay a second time.

## Policy Provisions

Some typical policy provisions regarding assignments may include the following:

1. The assignment will not be binding until the original, or a duplicate thereof, is filed at the insurance company's home office.

2. The insurance company assumes no obligation as to the effect, sufficiency, or validity of the assignment.

3. The assignment is subject to any indebtedness to the insurance company on the policy.

Therefore, it is important to ensure that an assignment is made properly, regardless of whether it is absolute or collateral. Be sure to consult your qualified insurance professional for specific guidance about your unique circumstances. $

## Tax Breaks for Elder Care

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support at those locations count toward meeting the IRS 50% threshold.

If your mother lives in your home, you are permitted to take into account the fair market value (FMV) of her accommodations, utilities, food, medicine, and other support items you provide when seeking to meet the 50% threshold. If, however, your mother is using Social Security benefits to pay for some of these items, this must be figured into the calculation of whether you cover more than half of her support costs. Since the rules on what items can be counted as necessary for support are complicated, and may vary from case to case, the IRS Publication 501 provides more specific information.

If your mother has met the IRS dependency tests, you can use any medical expenses you pay for her, including prescription drugs, medical equipment, hospital care, or doctor's visits, toward the itemized medical expenses deduction. The addition of your mother's expenses could help you meet the requirement that your medical costs exceed 7.5% of your adjusted gross income (AGI). If your mother is your dependent, premiums for supplementary Medicare coverage or long-term care insurance may also be included in this deduction. Even if your mother is not considered a dependent for exemption purposes because she earns too much, but has satisfied the other tests, you may still be able to count some medical expenses you have covered for your parent toward your own medical expenses deduction.

If your mother lives with you and requires continual care that is provided by paid caregivers while you and your spouse are at work, you may also be eligible to claim the non-refundable child and dependent care credit, which covers up to 35% of the cost of care. To qualify, your mother must be physically or mentally unable to care for herself, and you, as the adult child responsible for your parent's care, need to have earned income and work-related expenses. When claiming the credit, you must be able to properly identify your care provider, including the provider's name, address and Social Security or employer identification number. In some cases, these expenses can be covered by pre-tax payments you make through a flexible spending arrangement (FSA) sponsored by your employer. You must, however, choose between the FSA and the tax credit, as you are not permitted to claim both for the same expense.

In many families, brothers and sisters share the costs of caring for a parent. If you and your siblings share the cost, with none of you solely paying for half of the support, but with each contributing at least 10% toward parental care, the person claiming the parent as a dependent should file Form 2120 when filing his or her taxes, which will help you and your siblings account for the tax implications of a shared-care arrangement.

In another example, say your father is in a nursing home or assisted living facility. Your father's Social Security covers 40% of the facility's costs, and you and your brother split the remaining costs, with each paying 30%. Because more than half of your father's support comes from his two adult children, he can be claimed as a dependent by you or your brother. You may then agree with your brother to take turns claiming the deduction in successive tax years.

If you agree that your brother can claim your father as a dependent this tax year, your brother then files Form 2120 with his 1040 tax return. This form indicates that, although more than one sibling contributed to your father's support, the other has agreed to waive any tax exemption claim for that year. Your brother should get a signed statement from you acknowledging that you have waived your tax claims, and keep them in his records in case the IRS questions any exemption or medical deduction claims. $