YEAR END 2009

Charitable giving

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CHARITABLE GIVING

NONCASH DONATIONS CAN TAKE MANY FORMS

Year end is here, a time when gift-giving is on many people's minds. If you'd like to make a qualified charity a little happier this year, bear in mind that dollars and cents aren't your only option. Rather than hurting your personal cash flow by lowering the balance on your bank account, you might look to other assets to serve as a valuable donation — with some helpful tax benefits.

Your home or vacation home

Do you own a home or vacation home? If so, donating it to charity may seem like an extreme act of goodwill. Of course, the general idea when people do this isn't to give away the residence immediately and outright but to give a *remainder interest* to a qualifying charity for both charitable and income-tax-saving purposes.

In fact, the Internal Revenue Code permits taxpayers to donate a personal residence to charity and receive a current income tax deduction, even though the gift won't take effect until the taxpayer's death. Under the rules, the definition of a personal residence includes a:

- ✓ Condominium,
- ✓ Cooperative apartment,
- ✓ Farm, and
- ✓ House boat, yacht or motor home (in certain qualifying circumstances).

By donating a remainder interest in your home, you can receive a charitable income tax deduction equal to the present value of the remainder interest based on the current value of the residence and your age. And, because the remainder interest passes to charity upon your death, you will not be subject to estate tax on the property.

A spare vehicle

So maybe a home is a little too big of a noncash donation to consider. How about a spare vehicle? Aside from getting the vehicle off your hands, you can take a tax deduction limited to the amount that the charity receives when it sells the vehicle (even if the Blue Book® value is higher). If the charity instead decides to use the vehicle for its own activities, however, you'll be allowed to deduct the fair market value.

Whichever way the arrangement works out, the charity must tell you how the vehicle was used or whether it was sold and, within 30 days of your contribution or the vehicle's sale, provide you with Form 1098-C. In addition, the charity must disclose whether it provided any goods or services in exchange for the vehicle and, if it did, give you a good-faith estimate of their value.

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Art and other collectibles

Are you a collector? Rare paintings? Bejeweled bracelets? Stamps? If so, you can donate all or part of your collection to charity. Besides sharing your passion with others, you may save considerable tax dollars over selling your valuables outright. After all, gains from the sale of collectibles such as art, jewelry, antiques and stamp collections are still taxed at 28%, not the 15% rate that applies to most long-term capital gains.

If you decide to donate collectibles, bear in mind that you're generally allowed to deduct their fair market value only if the recipient charity uses them for its tax-exempt purpose.

So if, for instance, you give a painting to a nonprofit organization knowing that the organization is planning to sell the painting and invest the proceeds, you can deduct only your cost. But if you donate it to a museum for display or study, you can deduct the fair market value.

What's the damage? The cost of giving

When the waiter at a restaurant brings you the check, you may playfully ask, "What's the damage?" You probably wouldn't do that when making a donation, but charitable giving has a cost, too. The good news is that it's less than the amount you're actually giving — in some cases less than half as much.

Let's compare the cost of making four types of $500,000 donations. Assuming you're in the top federal tax bracket of 35%, have an adjusted cost basis of $150,000 in each of the noncash properties listed below and have taken $100,000 in depreciation deductions on the real estate, here's how the cost of each gift would break down:

Type of property	Cost calculation	Cost of gift*
Cash	$500,000 – (35% × $500,000)	$325,000
Stock	$500,000 – (35% × $500,000) – (15% × $350,000)	$272,500
Real estate	$500,000 – (35% × $500,000) – (25% × $100,000) – (15% × $250,000)	$262,500
Collectibles	$500,000 – (35% × $500,000) – (28% × $350,000)	$227,000

*Factors in the net cost of federal income tax only.

Appreciated stock

Given the rocky state of the stock market over the last year or so, just having appreciated stock may seem like a noteworthy accomplishment — and giving it away may seem out of the question. But donations of this nature remain a tax-savvy strategy.

By giving appreciated stock rather than cash (or the cash proceeds of a stock sale), you may qualify for a tax deduction equal to the stock's fair market value — just as if you'd sold it and donated the cash. But neither you nor the charity will have to pay capital gains tax on the appreciation.

There are limits: You may deduct appreciated stock contributions in the year of the contribution only up to 30% of your adjusted gross income. And you must have owned the stock for at least one year to qualify for the full deduction. Otherwise, you'll be limited to what you paid for the stock.

Due diligence

Making noncash donations isn't quite as straightforward as making cash ones. In fact, doing so calls for every bit of the due diligence you'd do before investing in a company or the like. Work with your CPA to ensure you do it right. ❒

FRAUD HAS STRUCK! WHAT NOW?

A CONTINGENCY PLAN CAN HELP MINIMIZE FALLOUT, EXPEDITE INVESTIGATION

It's the news no business owner wants to hear: Fraud has struck. So what now? Do you lock down the office and not allow anyone to leave until someone fesses up? Do you call the cops and ask them to send down a black-and-white?

One thing's for sure — you wouldn't be the first business owner to panic a bit upon the discovery of fraud. That's why preparing for a harrowing moment such as this with a fraud contingency plan can help ensure that you know just what to do to minimize the fallout from a fraud incident and get the investigation underway immediately.

Think bad ... and worse

A fraud contingency plan is your disaster road map. When you learn that a trusted employee has been stealing from you, you'll likely be distressed — which is no time to trust your instincts for damage control. With a well-designed contingency plan already in place, you won't have to rely on knee-jerk reactions.

No contingency plan can cover every fraud possibility, but yours should be as comprehensive as possible. Work with your senior management team and financial advisor to devise as many fraud scenarios as you can dream up. Consider how your internal controls could be breached by an enterprising fraudster, whether a rank-and-file employee, manager, executive or third party. Look at how someone could defraud the company acting alone or how employees and outsiders might work in collusion.

Next, decide which scenarios would be most likely to occur and which would be most damaging from a financial and public relations standpoint. Then decide what you'll do about them if they happen. For example, you'll need to define the objectives of a fraud investigation. Some companies want only to fire the person responsible, mitigate the damage and keep news of the incident from leaking. Others may want to prosecute offenders as examples to others.

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Pick your team

Your plan should be specific to the risks your company faces and assign distinct responsibilities. For this reason, you need a fraud response team.

Designate one person to lead the overall investigation and coordinate with staff and any third-party investigators. After that, assign specific tasks to knowledgeable managers. Your IT manager, for example, may be tasked with protecting your computer system to prevent loss of electronic records and your head of human resources may be responsible for maintaining employee morale.

Because fraud can wreak havoc with your company's reputation and weaken its standing in the community, you should also designate someone to manage external communications. This person should be prepared to deflect criticism and defend the company's stability as well as control the flow of information to the outside world.

Communicate with your employees

Employee communications are particularly important during a fraud investigation. Employees who don't know what's going on will speculate, and they may not be particularly circumspect about it. Consult your legal and financial advisors to clarify whether any information should be withheld, but be as honest with your employees as you can.

It's equally important to make your response visible because it strengthens your fraud-prevention efforts. If employees know you take fraud seriously, they'll be less likely to attempt it themselves and more likely to report suspicious activities on the part of others.

Integrate your efforts

A fraud contingency plan is, in and of itself, an important measure against what could be a devastating crime affecting your company. But it shouldn't stand alone: Integrate your plan into a greater suite of risk management programs covering topics such as natural disasters, disease outbreaks, IT failures — even terrorist attacks.

And, most of all, keep your fraud contingency plan updated. Revisit it annually at least to make sure you're incorporating newer fraud schemes and changing the names of those on your fraud response team to account for employee turnover. Having an outdated fraud contingency plan in place could significantly hinder your efforts to combat an incidence of wrongdoing. ❐

Moneylines: News Briefs for Businesses

Anti-identity-theft rule in effect. The Fair and Accurate Credit Transactions Act was signed into law in December of 2003, but one important part of the law — the Red Flags Rule — just went into full-enforcement mode in November. It requires any company that offers its customers any sort of credit arrangement (even a simple month-end bill) to establish a formal "Red Flag" plan to fight identity theft. If this is news to you, the time to learn more about the rule is now, because penalties, fines and an FTC investigation may occur as a result of noncompliance.

Health insurers often compete on a severely slanted playing field. One reason health benefits are so expensive may be that the few major health insurers out there don't have much competition. In a recent American Medical Association survey of 314 major metropolitan areas, 94% could be called "highly concentrated" when it comes to providers — meaning only one or two insurers dominate those markets. Regularly review your health benefits provider to determine whether you're getting the best deal possible and if any alternatives are available.

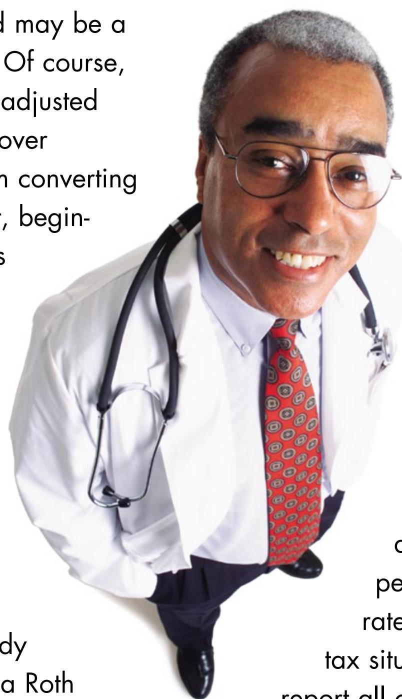
Pay raises probably won't go much higher in 2010. If you struggled to give employees raises over the past year, you're not alone. Median 2009 pay raises had an estimated range of between 2% and 3%, according to a recent study by HR consultants Watson Wyatt Worldwide and Hay Group. The same survey forecasts raises to run around 3% nationwide next year. If your company faces pay raise problems, look into other ways to keep staff morale up, such as flexible work schedules and advanced training.

Many businesses consider loan covenant amendments. If your company finds itself not being able to maintain compliance with its bank loan covenants (for troubles related to items such as EBITDA and debt-to-equity ratio), you might want to call your bank about a loan covenant amendment. It's an increasingly common practice among bigger companies — 98 publicly disclosed covenant amendments to high-yield corporate loan agreements were reported in Standard & Poor's Leveraged Commentary & Data in first quarter 2009. That's up from 62 in the previous quarter. But be careful — many large businesses were violating these covenants, and smaller ones might also do so.

SAVVY PLANNER READIES FOR 2010 IRA RULE CHANGES

Gerald is a 63-year-old physician who, for many years, channeled money into a traditional 401(k), which he recently rolled over into a traditional IRA when he left his hospital position to start his own practice. The tax-deferred contributions seemed like a good idea at the time, but he has no intention of retiring within the next decade. Thus, he's bothered by the account's required minimum distributions (RMDs), which he'll have to start taking after he turns age 70½. When he mentions this to his financial advisor, some great IRA news comes to light.

His advisor explains that Gerald may be a good candidate for a Roth IRA. Of course, under current law, his modified adjusted gross income (MAGI), which is over $100,000, disqualifies him from converting his traditional IRA to a Roth. But, beginning in 2010, that MAGI limit is no more and virtually anyone can convert.



Why convert?

As mentioned, among the chief reasons Gerald should consider converting is to avoid the RMDs that would force him to begin depleting his retirement funds before he's ready to retire. Leaving these funds in a Roth IRA will give them more time to grow — income-tax free.

Another good reason to convert is, oddly enough, precisely the opposite — withdrawals from a Roth IRA can be more attractive than withdrawals from a traditional IRA. Unlike traditional IRA contributions, Roth contributions (along with any funds put in the account via a conversion) can be withdrawn at will with no taxes or early-withdrawal penalties. In addition, withdrawals of Roth IRA *earnings* will be tax- and penalty-free as long as the account owner is at least 59½ years old and has owned the account for five years. (Early withdrawals of Roth IRA earnings may be subject to taxes and penalties, though some exceptions apply.)

Is there a cost?

There is a tax cost for converting a traditional IRA to a Roth. Namely, Gerald will be taxed on the amount he converts from the traditional IRA because he's basically moving assets from an account funded with tax-deferred contributions (the traditional) to one funded with after-tax dollars (the Roth).

His advisor mentions that, for 2010 conversions, the law allows Gerald to report the income evenly over the *following* two years. That is, he'll report 50% in 2011 and 50% in 2012. In doing so, he'll be able to defer recognition of the income and perhaps avoid being taxed at a higher rate. On the other hand, should Gerald's tax situation warrant doing so, he can elect to report all of the income in 2010.

Is it January yet?

Naturally, if Gerald is serious about a Roth conversion, there are a number of other details he and his advisor will have to work out. Nonetheless, Gerald leaves his financial advisor's office with one more reason to look forward to the new year. ❐

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