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The Road to April 15: A Year-End Tune-Up for Your Taxes

Let's think of financial planning as a superhighway, with such destinations as paying for college, planning for your children's weddings, and enjoying a comfortable, secure retirement up ahead. Along the way, you have to pull over and stop at a "toll booth" every year—April 15, when your taxes are due. If you're like many of us, you probably resume your journey with a grumble or two about the toll that Uncle Sam is taking on your assets—and a concern about whether or not you will have enough "fuel" left to ultimately reach your financial destinations.

The truth is, by carefully mapping out your financial direction now you can decrease your taxable income —significantly reducing your taxes and allowing you to keep more in your pocket for life's journey. If you have philanthropic leanings, you can also help ensure Western Illinois University can continue to pursue its mission.

The key to success, however, is ***timing***. To see the best results at tax time, you must take action by this year's end. You might think of this as you would a tune-up for your car—strategic action now to keep everything running smoothly and forgo headaches later. This issue of *Planner* explores ways to tune up your tax strategy and keep you zipping along toward your personal, financial, and charitable destinations.

The overall tune-up goal is pretty simple. Best of all, it doesn't involve messy work with a wrench and oil or grease under the hood of anything.

Less Income, Less Tax

Wait a minute*, you're likely thinking. *I want less tax—not less income.

We are not talking about dramatically altering your lifestyle just so you can pay a few less dollars to the IRS. Instead, the goal is to maintain or improve your financial situation by reducing your ***taxable*** income. You will pay less tax when you lower your taxable income, getting more mileage out of your assets as the IRS recedes in your rearview mirror. Here are some effective strategies when you conduct your tune-up:

Strategy One:

Increase your deductions. Some of the easiest ways to reduce your taxable income are to:

Pay as much interest as feasible on a mortgage or home-equity loan before December 31.

Homeowners can receive a much-needed break since mortgage interest is still one of the best and largest deductions available to most people. Generally, interest paid on up to $1,000,000 of total mortgage-acquisition debt on your first and second homes is deductible. In addition, you can deduct interest on as much as $100,000 of home-equity loans.

By contrast, none of the personal interest that you pay on credit cards, auto loans, and the like is deductible. ***Planning pointer:*** It may make more sense for you to convert your personal interest debts into a home-equity loan. It's a good idea to talk to your advisor and your banker before signing anything.

"Withdraw" from the tax on your mandated IRA withdrawals with a charitable gift.

Are you approaching or over 70$\frac{1}{2}$? You may be facing the requirement of having to start drawing down your IRA benefits even though you might not really need the funds. The problem is that the funds that have grown tax-free all those years within the

Net Cost of a $1,000 Gift

Tax Bracket	Tax Savings	Net Cost
10%	$100	$900
15%	$150	$850
25%	$250	$750
28%	$280	$720
33%	$330	$670
35%	$350	$650

When you choose to support charitable causes such as the WIU Foundation, the government shares the cost in the form of tax savings. This chart shows the net cost of giving for persons who itemize.

IRA (or other qualified plan) are *fully* taxable when they are distributed. ***Charitable planning pointer:*** Consider making a charitable gift to the WIU Foundation to help soften that tax hit.

Example: Bill, 72, must take $100,000 from his IRA this year at a tax cost of $35,000 in his 35% bracket. If he made an outright gift of $50,000 to the WIU Foundation, he would save $17,500 in income tax.

Charitable planning pointer: An even better option would be for Bill to give appreciated stock to the WIU Foundation and use his IRA distribution to reestablish his position in the stock. Bill would receive a charitable tax deduction for the full fair-market value of the stock *and* avoid the capital- gain tax that would otherwise be paid if he had chosen to sell instead.

Make a larger gift to the WIU Foundation.

A charitable deduction is one of the simplest ways to reduce your taxes. A cash gift is deductible up to 50% of your adjusted gross income (AGI). The full fair-market value of gifts of long-term appreciated property is deductible up to 30% of your AGI. If the amount of your gift exceeds the allowable deduction, the excess may be carried over for five years.

Special Note: For cash gifts made between August 28 and December 31, 2005, the charitable deduction limit is increased to 100% of AGI. Please see the insert card for more information.

Strategy Two:

Generate more tax-free income. Try one of these approaches:

Buy municipal bonds.

Municipal bonds have long been a favorite of anyone looking for tax-free income. But they require careful examination: Usually, the higher the rating for a municipal bond, the lower its payout rate. ***Planning pointer:*** Calculate whether a municipal bond would be a valuable part of your portfolio by converting the payout rate into a taxable equivalent using your marginal tax rate.

Example: John's income-tax rate is 33%. He discovers he can buy tax-free bonds that pay 3.5%, which is equivalent to a 5.22% taxable payout. John can buy U.S. Treasury taxable bonds that pay 4.2%. Clearly, the tax-free bonds are the better investment.

Contribute for a charitable gift annuity with the WIU Foundation.

A charitable gift annuity works like this: In exchange for a gift such as cash or securities, you will receive a guaranteed stream of income for life from the WIU Foundation. Some of the income may be tax-free over your life expectancy. The older you are when the gift annuity begins, the more tax-free income you receive. Once you figure in the income and the charitable deduction, your tax savings can be significant.

Once you figure in your tax-free income and your charitable deduction, the tax savings from a charitable gift annuity can be significant.

Example: Ruth, 70, makes a cash contribution of $10,000, in exchange for a charitable gift annuity with the WIU Foundation. In return, she receives an immediate charitable income-tax deduction of $3,866 to help offset her current tax bill. She also receives an annual annuity of $650 for life. Of this amount, $264 has to be reported as ordinary income, but the remaining $386 is treated as a tax-free return of principal over her actuarial life expectancy—15.9 years for Ruth.

$10,000 Cash Gift Annuity

Age	Annuity Payment	Tax-Free Portion	Charitable Deduction
60	$570	$291	$2,977
65	$600	$329	$3,447
70	$650	$386	$3,866
75	$710	$454	$4,366
80	$800	$547	$4,855

The Road to April 15 *Continued from page 3*

Strategy Three:

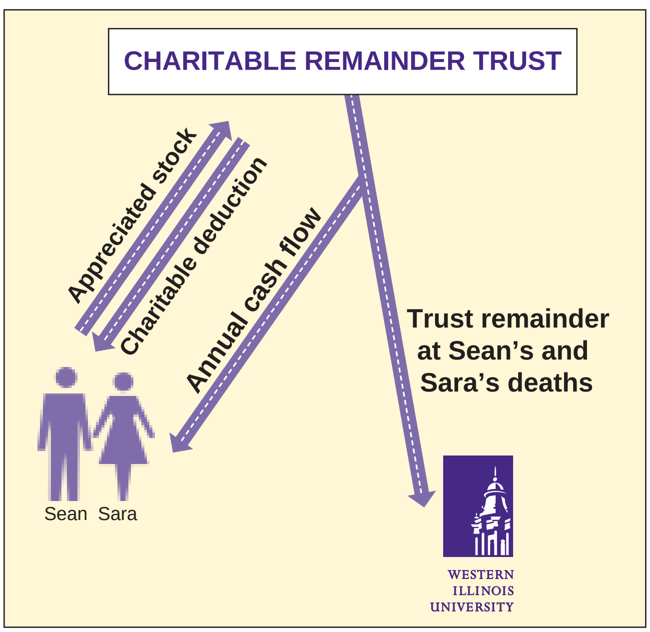
Reduce or eliminate capital gain. If you have appreciated property held for more than a year, a sale could possibly generate substantial tax on the capital gain (at rates as high as 15%). Instead, consider these options:

Delay the timing of the sale of appreciated property.

By delaying the timing of the sale until next year, you avoid having to pay the capital-gain on your 2005 taxes. If the property—whether appreciated stock, real estate, etc.—is in danger of dropping in value, however, it may be more beneficial to sell now in spite of the gain.

Make a charitable gift to the WIU Foundation.

Even more tax-wise than delaying the sale of your appreciated asset until next year would be using it as a charitable gift. You receive a charitable deduction for the full fair-market value of the asset on the date of the gift. Even if the value of the asset does fall in the future, your deduction remains the same.



Alternatively, you may find a gift of appreciated property to a charitable trust with the WIU Foundation even more beneficial. You would avoid paying any capital-gain tax on the initial transfer of the property to the trust, and you would receive a significant charitable tax deduction as well. Since a trust is tax-exempt, it can sell stock and not owe any taxes. This means the entire value of the stock stays at work for you, producing another source of cash flow, as shown in the chart at left.

We Are Here to Help

Year-end tax planning is like examining a road map: After studying various options, you decide on the best route to your personal, financial, and charitable destinations. This issue of *Planner* has explored several strategies that you can employ to reduce your taxable income and bring down your taxes while helping the WIU Foundation. To assist in your planning, we would like you to receive a complimentary copy of our new booklet, ***Charitable Tax Planning for 2005: Looking Ahead to April 15.*** To request your copy, simply return the enclosed card or call our office.

Just the Chance *Continued from page 1*

I am so happy that Frieda called. If she hadn't, I probably would have never had the pleasure of meeting her and Bill. So, if you have made estate plans that include Western or would just like to discuss some ideas, please call. It isn't the size of the gift but the thoughtfulness that is most important to me—along with just the chance to say thank you for providing for Western's future!

My best wishes to you!

Brad Bainter

Brad Bainter
WIU Foundation

Foundation and
Development Office
1 University Circle
303 Sherman Hall
Western Illinois University
Macomb, Illinois 61455
(309) 298-1861/1808
FAX (309) 298-1761