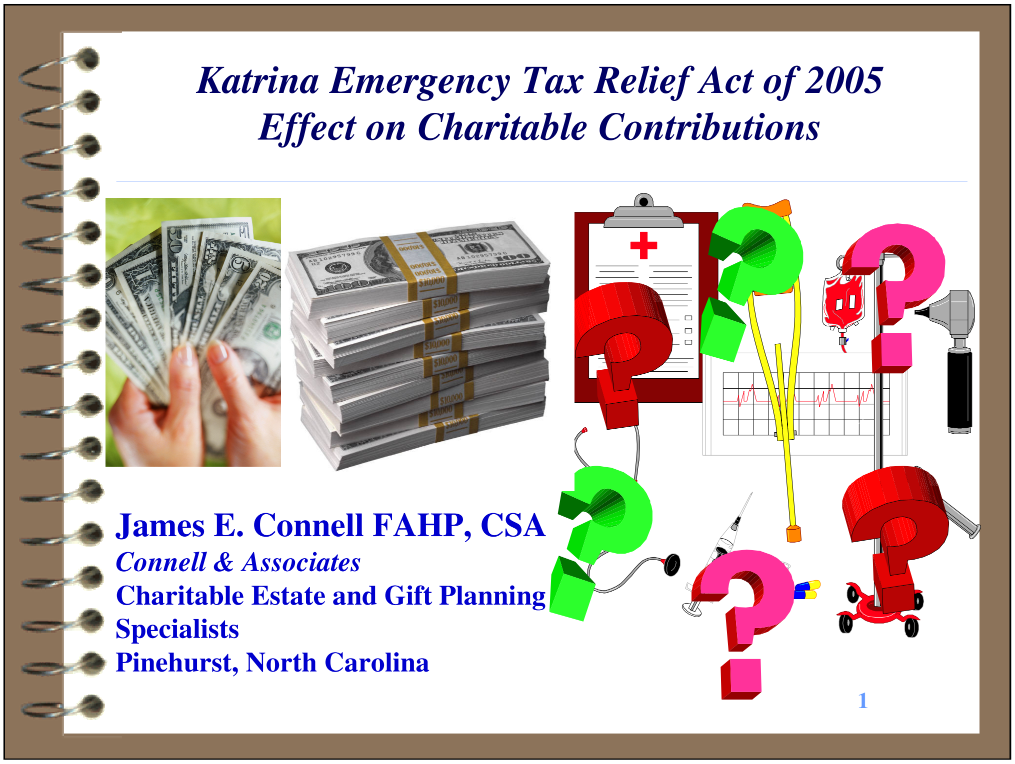
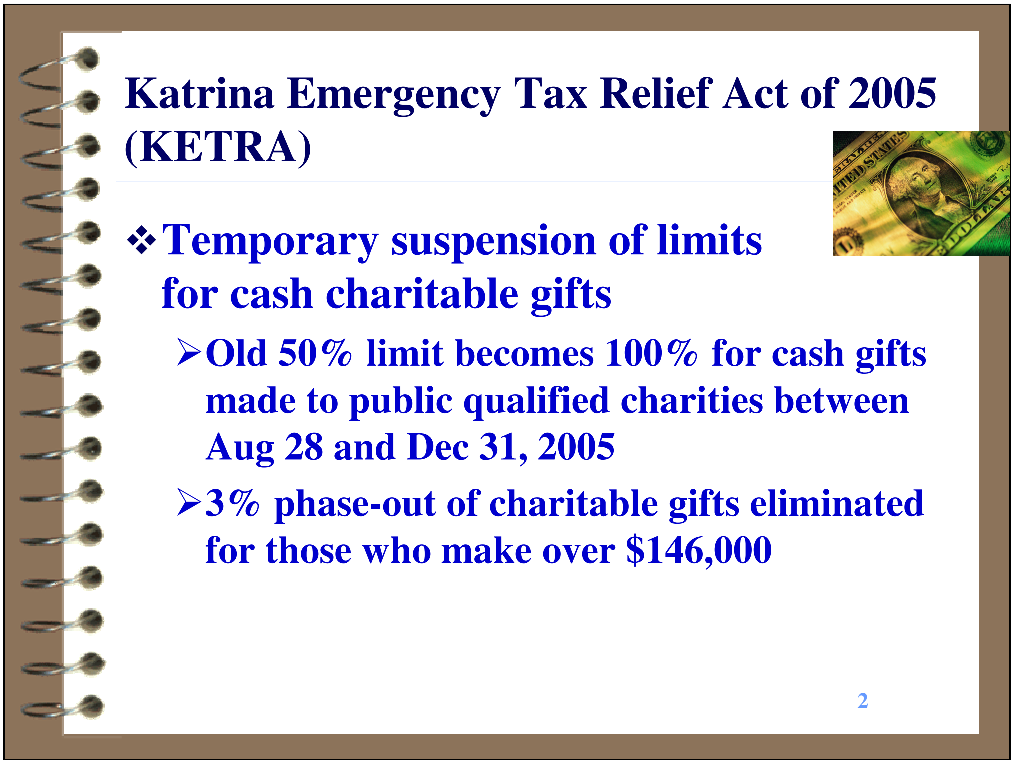


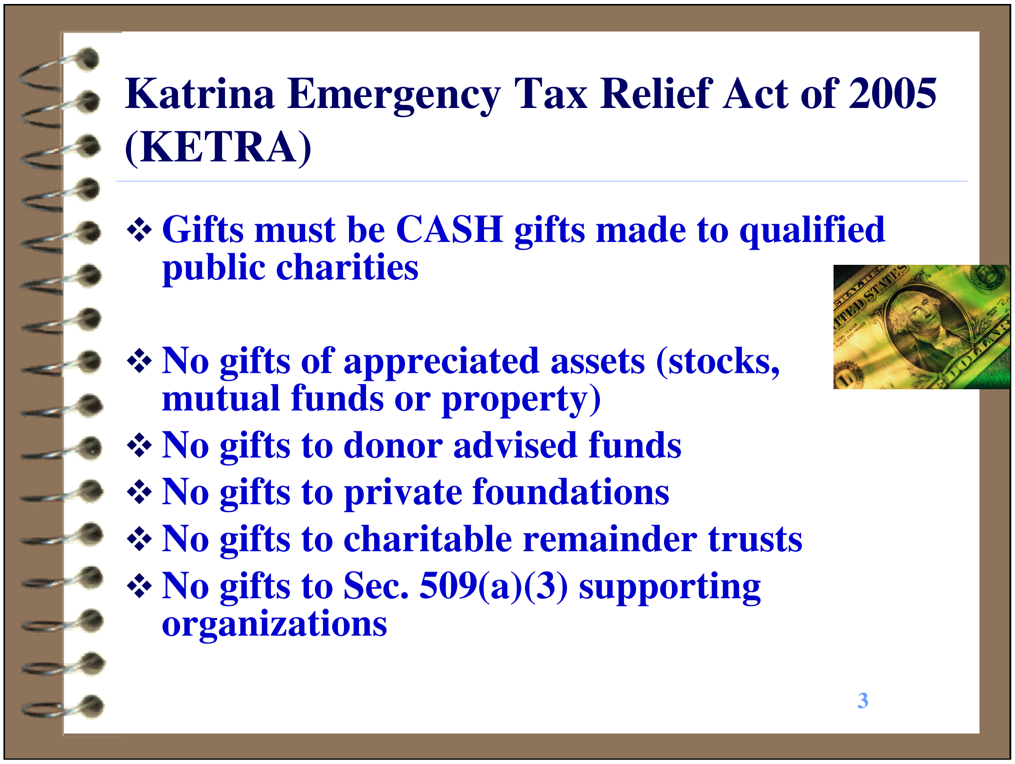
James E. Connell & Associates
Charitable Estate and Gift Planning Specialists
Box 3335, Pinehurst, North Carolina 28374
Phone 910-295-6800 …. Fax 910-295-6866
"Building Endowments for American Charities"



On September 23rd, the President signed into law the Katrina Emergency Tax Relief Act of 2005 (KETRA). Among its many provisions are limited time incentives for increasing charitable gifts such as the elimination of itemized deductions (including charitable gifts) by 3% of the amount by which Adjusted Gross Income exceeds $145,950 ($79,975 for married persons filing separately) is also waived for qualified gifts (will apply up to about 10% of filers). Also, the act suspends the 50% of Adjusted Gross Income limitation on charitable donations of cash gifts only (not appreciated assets) that especially apply to wealthier donors. While average giving nationally is only on average about 2% of income normally, there are some people who (especially those older retired wealthy individuals, with reduced incomes but large asset bases, who are some years hitting the maximum threshold) that will refrain from further giving for the year or the next couple of years. The effect of the elimination of the 3% reduction is significant for any high income individual.

For people taking advantage of either of these provisions, 2005 could be a unique opportunity to give beyond their normal pattern. Some wealthy donors may decide to pay up outstanding pledges that are not due for one or more years going forward. Others may make new gifts that they had not planned to make. Nonprofits and their fundraising counsel may want to encourage donors to take full advantage of these provisions for non-hurricane related giving this year because they are not restricted only to gifts related to these specific disasters. In any event, you may want to take a look at a special memo that explains this in more detail visit the website of Robert Sharpe, head of the Sharpe Group - planned giving consultants, by clicking on http://www.sharpenet.com/ketra

James E. Connell & Associates
Charitable Estate and Gift Planning Specialists
Box 3335, Pinehurst, North Carolina 28374
Phone 910-295-6800 …. Fax 910-295-6866
"Building Endowments for American Charities"



KETRA has several requirements for the gift to be fully deductible against adjusted gross income.

The gift must be in cash. Gifts of appreciated assets such as the typical appreciated stock gift do not qualify and will only be deductible up to 30% of AGI.

Gifts to donor advised funds at community foundations and with national charities such as the Fidelity Gift Fund do not qualify.

Gifts to any private foundation does not qualify as the donor would still maintain control over the donated asset without an immediate charitable impact.

Gifts to charitable remainder unitrusts or pooled income funds do not qualify because these are trust entities and not public charities.

Gifts to supporting organizations classified as 509(a)3 charitable organizations also do not qualify.

Charities should check their IRS tax letters carefully to see under which provisions of the tax law they received their 501(c)3 tax exemption.

Advisors should first check with the charity or charities in the case of multiple gifts to make sure their client's gift will be fully deductible.

Gifts that do not qualify for the KETRA charitable incentives will still qualify for either the 50% or 30% limit on the deductibility of charitable gifts to public charities.

James E. Connell & Associates
Charitable Estate and Gift Planning Specialists
Box 3335, Pinehurst, North Carolina 28374
Phone 910-295-6800 …. Fax 910-295-6866
"Building Endowments for American Charities"

Katrina Emergency Tax Relief Act of 2005 (KETRA)

- **Where to get the cash for gift without increasing AGI?**
  - **Assets held in money market funds**
  - **CDs that are maturing**
  - **Sale of stock held at a loss**
  - **Cash borrowed against equity**

4

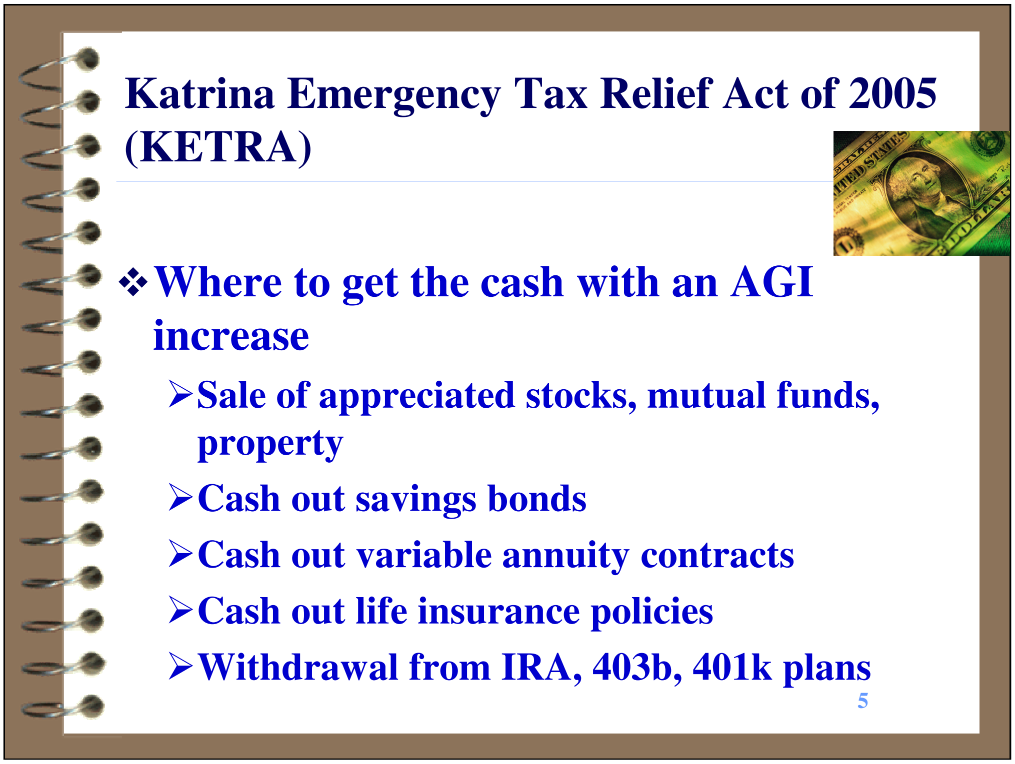
To take advantage of the KETRA 100% deductible charitable contributions the gift must be to a public charity and made in CASH.

The question for the donor to consider is where or how do I get the cash to make the contribution without increasing my adjusted gross income. This strategy will generate the maximum current tax benefits.

Some donors may have significant cash invested in money market accounts or cash may come available from recently matured certificates of deposit accounts.

Additional sources of cash could be stocks sold at a loss or in some aggressive circumstances even borrowing the cash against personal equity with the plan to replace the borrowed funds at some future date.

James E. Connell & Associates
Charitable Estate and Gift Planning Specialists
Box 3335, Pinehurst, North Carolina 28374
Phone 910-295-6800 …. Fax 910-295-6866
"Building Endowments for American Charities"

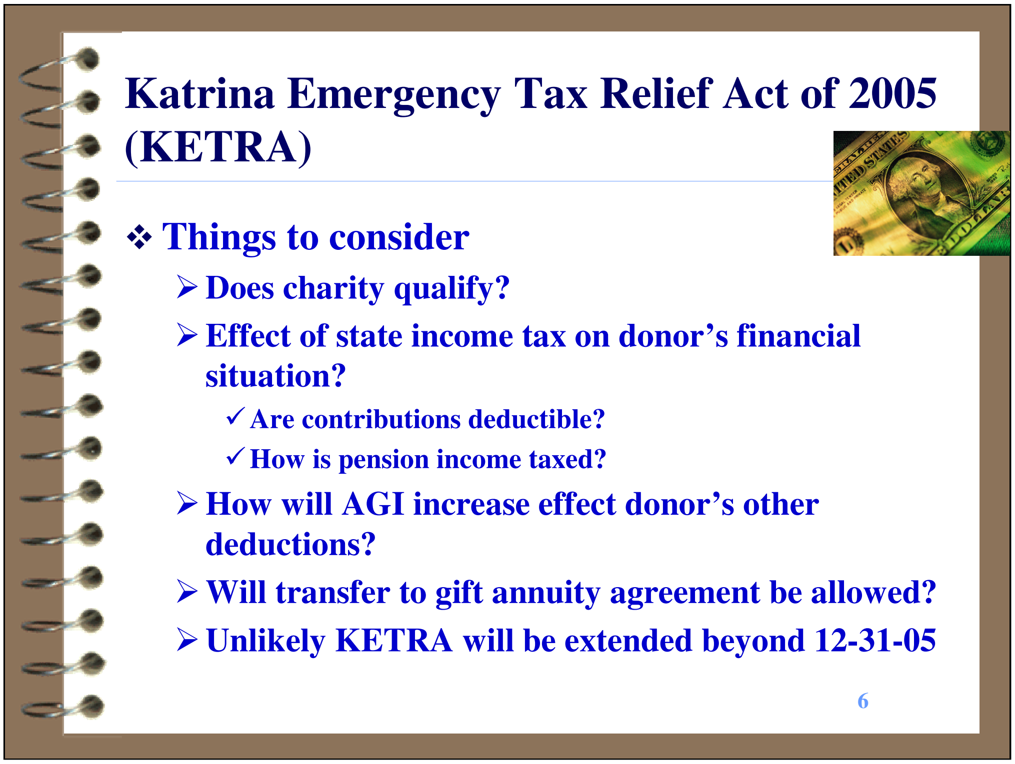


There are several strategies that may be considered to raise gift cash which will have the effect of increasing a person's adjusted gross income. These strategies may be employed in combination with the prior suggested strategies or may be the only possible source of the gift cash.

An individual could consider selling securities at a profit, reporting the long term capital gain and donating some or all of the resulting cash. One of the advantages of this strategy is it increases the individuals AGI with much of the increase taxed at the 5%, 10% or 15% long term capital gains rates while the charitable deduction reduces the individuals taxable income at the marginal tax rate.

Individuals who have owned saving bonds for a long time could consider cashing in the bonds and donating the resulting cash. Since the bonds do not provide any current income to the individual and have a cost basis this strategy should be considered.

Cash can also be obtained from cashing out variable annuity policies held beyond the redemption fee period, cash obtained from unused life insurance policies and cash withdrawn from retirement accounts. The individual should be age 59 ½ or older to consider the latter strategy.



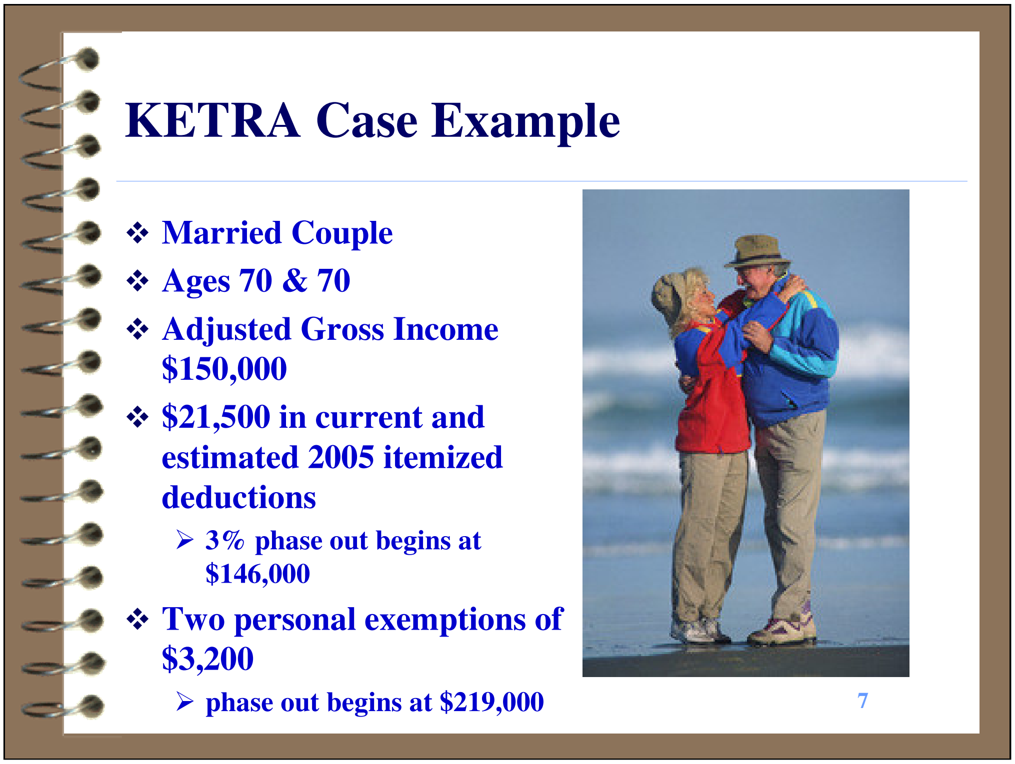
As various strategies are evaluated the donor and advisor should consider the following. As was previously stated the charity must qualify for the KETRA treatment of the gift for the tax reduction benefit to be achieved.

Additionally the impact of state income taxes on the person's financial situation should be considered. Some states do not allow charitable contributions to be deducted against state taxable income. In this case the donor could reduce Federal income taxes while having a significant increase in their state income taxes, thus lowering the overall benefit.

It is important to note the 3% reduction rule suspension only applies to charitable contributions made during the KETRA period. Other deduction such as state and local income taxes, mortgage interest, other charitable deductions made outside the KETRA period, and real estate taxes are still effected by the 3% reduction rule when the donor's AGI exceeds $146,000.

There is also a reduction in the personal exemption that phases out beginning with AGIs exceeding $219,000.

There have been several inquiries about how charitable gift annuities will be treated. A charitable gift annuity represents a full transfer of assets to a charity in return for the charities promise of guaranteed lifetime payments. The regulations specifically restrict charitable remainder unitrust transfers but are silent on charitable gift annuities. When a gift annuity is established the donor will only receive a partial deduction of the transferred assets representing the calculated gift portion of the asset transfer. Charities and advisors should explore this option carefully especially in regulated states where the charity is required to have a segregated reserve fund.

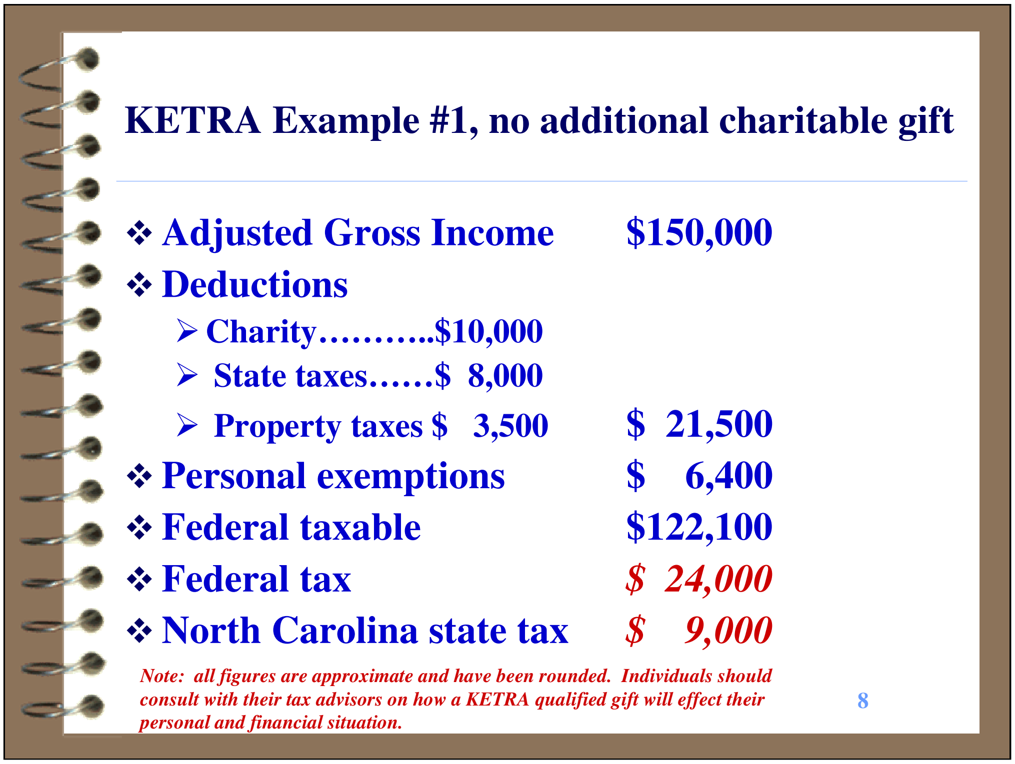


KETRA benefits can best be explored by example. Here a couple both age 70 will have expected 2005 adjusted gross income of $150,000. They have made prior KETRA period charitable gift of $10,000 in cash, paid $8,000 in state and local taxes in 2005, and have property tax deductions of $3,500. They have no mortgage interest deductions.

The couple is exploring the option of completing a major pledge they have to a qualified charity. Their advisors are exploring several options for them to consider.

They do not wish to totally eliminate their 2005 tax liability but that may be possible by increasing their anticipated gift amount.

James E. Connell & Associates
Charitable Estate and Gift Planning Specialists
Box 3335, Pinehurst, North Carolina 28374
Phone 910-295-6800 …. Fax 910-295-6866
"Building Endowments for American Charities"

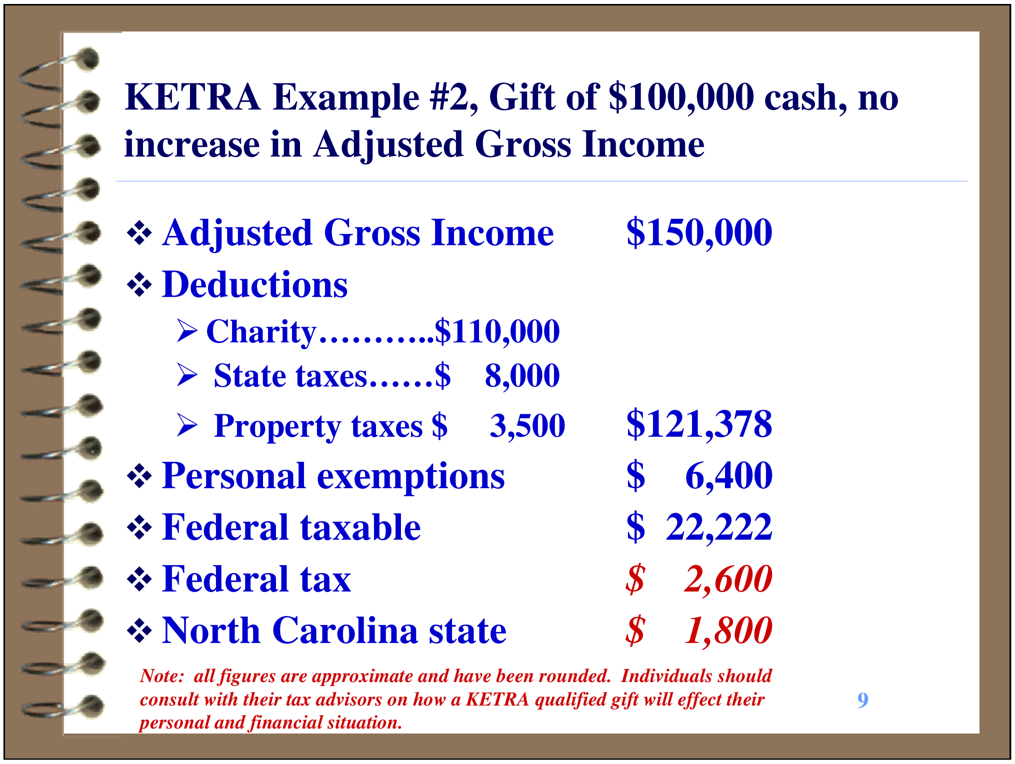


The advisors start by examining the financial impact without an anticipated increase in the charitable contribution amount. The individuals will have a Federal tax due of $24,000 and a North Carolina state tax due of $9,000 for a total tax bill of $33,000.

Note: all figures have been rounded for presentation purposes.

The individuals deductions are effected by the 3% reduction rule but they receive the maximum personal exemption benefit.

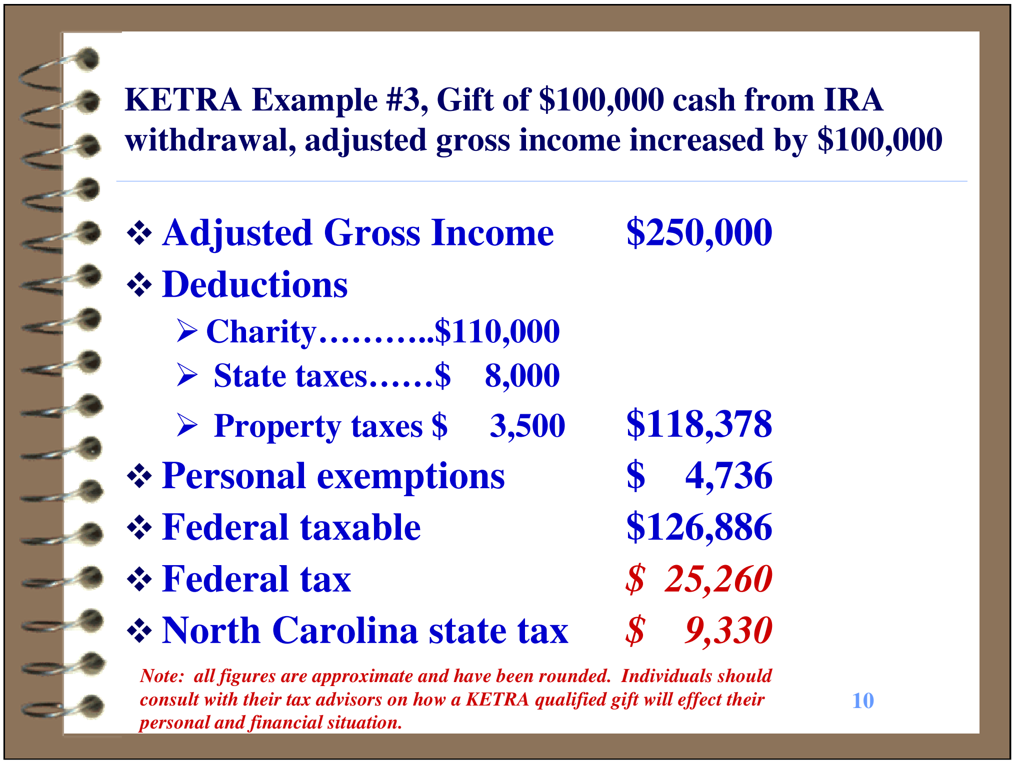
James E. Connell & Associates
Charitable Estate and Gift Planning Specialists
Box 3335, Pinehurst, North Carolina 28374
Phone 910-295-6800 …. Fax 910-295-6866
"Building Endowments for American Charities"



The donors have significant cash assets in fixed income investments and can consider a $100,000 gift by withdrawing the amount from their current money market funds. While the donors will give up the lifetime earning on the contributed assets they wish to complete their pledge to their favorite charity so it can receive the immediate benefit of gift.

The impact of the KETRA qualified gift is a significant reduction in both Federal and state income tax liability. With a larger gift amount they could have eliminated their total tax bill for 2005.

James E. Connell & Associates
Charitable Estate and Gift Planning Specialists
Box 3335, Pinehurst, North Carolina 28374
Phone 910-295-6800 …. Fax 910-295-6866
"Building Endowments for American Charities"



As an alternative the advisors considered a $100,000 withdrawal from what the donors considered an over funded retirement account.

This strategy increased the donors adjusted gross income. The resulting increase in income had an impact on the amount of the reduction in their prior deductions. The result was a tax increase of $1,260 from the baseline tax amount listed in slide #8. There was also an increase in their North Carolina tax of $330.

While many individuals have significant assets within retirement accounts in most situations the withdrawal of these assets will actually increase rather than decrease individual's taxes. It also has the possibility, as is present in this case, of reducing the effect of the personal exemption.

James E. Connell & Associates
Charitable Estate and Gift Planning Specialists
Box 3335, Pinehurst, North Carolina 28374
Phone 910-295-6800 …. Fax 910-295-6866
"Building Endowments for American Charities"

KETRA Example #4, Gift of $100,000 cash from savings bonds with $20,000 cost basis, adjusted gross income increased by $80,000

- **Adjusted Gross Income** **$230,000**
- **Deductions**
  - **Charity………..$110,000**
  - **State taxes……$ 8,000**
  - **Property taxes $ 3,500** **$118,978**
- **Personal exemptions** **$ 5,760**
- **Federal taxable** **$105,262**
- **Federal tax** ***$ 19,646***
- **North Carolina state tax** ***$ 7,654***
- ***Note: Same principal applies to life insurance which is terminated for cash value and a variable annuity which is cashed in after the fee deferral period.***

Savings bonds are the most widely held asset in America. In 2004 the US Treasury eliminated the opportunity of individuals converting E and EE bonds into HH bonds. This means the only way individuals can convert savings bonds from a non-income producing situation to an income producing situation is to cash in the bonds, report the taxable interest, reinvest the assets and pay the resulting taxes.

Because most seniors do not like to pay taxes many savings bonds are sitting in safety deposit boxes gathering interest. Some individuals may also have bonds held beyond the 30 year maturity period that are no longer earning interest but are reluctant to cash in the bonds because of the tax liability.

These individuals could consider the strategy of donating the bonds. Under the KETRA act the donation of the cash from the bonds could be totally tax sheltered.

In the above example the donors have a cost basis in savings bonds of $20,000 and a value of $100,000. Cashing in the bonds increases their adjusted gross income of $80,000 but receive a charitable deduction of $100,000.

There is an overall reduction in both their Federal and state income tax liability and they have used a nonproductive assets to complete their charitable gift.

KETRA Example #5, Gift of $100,000 cash from stock sold at loss, cost basis $125,000, adjusted gross income decreased by $3,000

❖ Adjusted Gross Income	$147,000
❖ Deductions	
➢ Charity………..$110,000	
➢ State taxes……$ 8,000	
➢ Property taxes $ 3,500	$121,468
❖ Personal exemptions	$ 6,400
❖ Federal taxable	$ 19,132
❖ Federal tax	*$ 2,140*
❖ North Carolina state tax	*$ 1,540*

❖ *Note: Balance of loss used to offset other gains*

12

Selling assets at a loss may be considered an acceptable strategy in some situations. The individual may hold the stock either short term or long term. The cash received from the sale is used to make the charitable gift. The resulting long or short term loss is used to reduce other long or short term gains and the maximum $3,000 loss is reported on the joint tax return.

The financial impact is considerable since this strategy results in a decrease in adjusted gross income rather than an increase in AGI.

James E. Connell & Associates
Charitable Estate and Gift Planning Specialists
Box 3335, Pinehurst, North Carolina 28374
Phone 910-295-6800 …. Fax 910-295-6866
"Building Endowments for American Charities"

KETRA Example #6, Gift of $100,000 cash from stock sold at gain, cost basis $50,000, adjusted gross income increased by $50,000

❖ **Adjusted Gross Income**	**$200,000**
❖ **Deductions**	
➢ **Charity………..$110,000**	
➢ **State taxes……$ 8,000**	
➢ **Property taxes $ 3,500**	**$119,898**
❖ **Personal exemptions**	**$ 6,400**
❖ **Federal taxable**	**$ 73,722**
❖ **Federal tax**	***$ 6,760***
❖ **North Carolina state tax**	***$ 5,360***

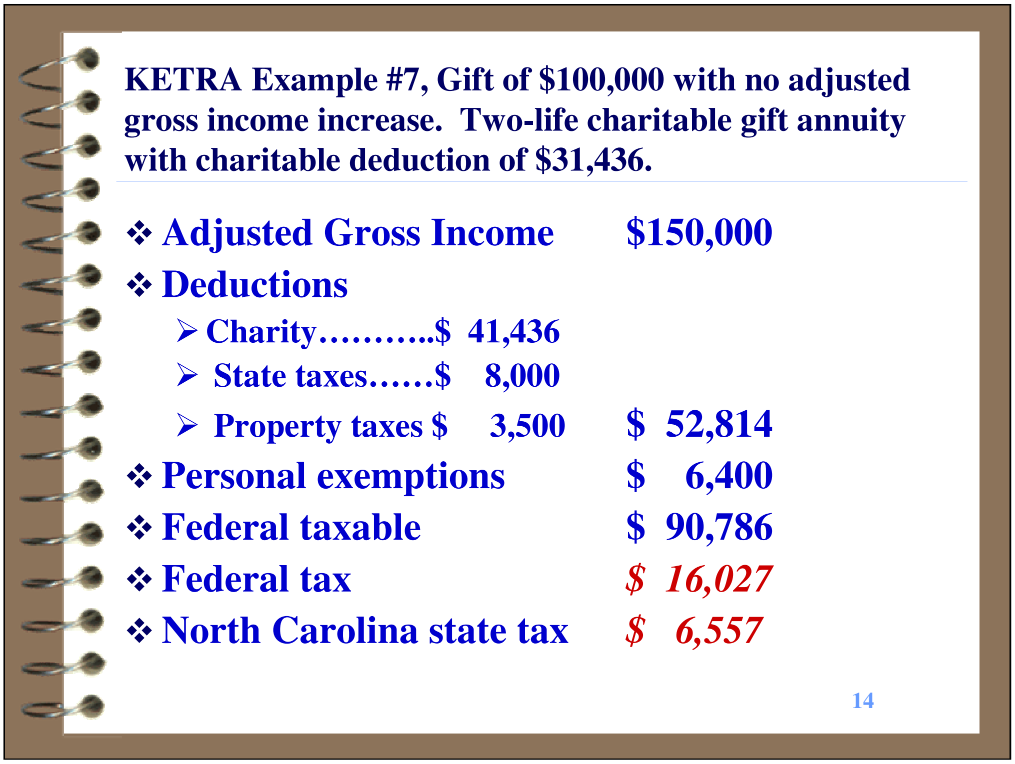
❖ ***Note: Some capital gain taxed @ 5% and some @ 15%, charitable deduction @ 25%***

13

In some situations it may be beneficial to calculate if it is prudent to sell stock at a gain, either a large or a small gain, and donate the resulting cash.

This strategy should be considered because of the differential between the long term capital gains rates and the ordinary income rates.

When the individuals adjusted gross income is reduces there is the possibility some or all of the capital gain could be taxed at the preferential 5% or 15% long term capital gain rates.



Some individuals may not be in a possession to contribute a large some to charity and sacrifice the lifetime payments from the asset. In this case advisors may consider establishing a charitable gift annuity.

A gift annuity provides fixed, guaranteed lifetime payments to the donor and if desired one additional beneficiary. Payments are determined by the age(s) of each annuitant. A portion of the payments is received completely income tax free. Payments may be made immediately or the annuity payments may be deferred for a term selected by the donor.

When a charitable gift annuity is established the donor receives an immediate income tax deduction for the gift portion of the agreement. This gift portion is always less than the gift amount.

In the above example the gift amount for a $100,000 two-life agreement is $31,436.

The result on the individuals tax return is a decrease in Federal taxable income and a reduction in taxes.

Advisors should evaluate this strategy carefully as the KETRA regulations are silent on charitable gift annuities. Most commentators have indicated because gift annuities represent an outright gift to the qualified charity and the charity could use the funds for its mission and accept the payment liabilities gift annuities should qualify for the KETRA benefits in states where gift annuities are not highly regulated.

KETRA Example #8, Gift of $100,000 with adjusted gross income increase. Two-life charitable gift annuity with charitable deduction of $31,436.

❖ Adjusted Gross Income	$250,000
❖ Deductions	
➢ Charity……….$ 41,436	
➢ State taxes……$ 8,000	
➢ Property taxes $ 3,500	$ 49,814
❖ Personal exemptions	$ 4,736
❖ Federal taxable	$ 195,450
❖ Federal tax	*$ 45,100*
❖ North Carolina state tax	*$ 14,651*

15

As the above calculations indicate it is not financially beneficial to increase the individuals adjusted gross income and only receive a partial offset to the increased income thru the use of the partial charitable deduction created by the gift annuity contract.

James E. Connell & Associates
Charitable Estate and Gift Planning Specialists
Box 3335, Pinehurst, North Carolina 28374
Phone 910-295-6800 …. Fax 910-295-6866
"Building Endowments for American Charities"

KETRA Act of 2005 - Credits

- **James E. Connell, FAHP, CSA**
  Charitable Estate and Gift Planning Specialists
  PO Box 3335
  Pinehurst, NC 28374
  910-295-6800
  jec42644@aol.com www.connellandassoc.com
- **Darlene Vaughn, CPA**
  Johnson & Vaughn CPA, PLLC
  295 Olmsted Blvd, Suite 1
  Pinehurst, NC 28374
  910-295-3800
  dvaughn@pinehurst.net
- **For further information see the following articles on the Planned Giving Design Center, www.pgdc.com 1. KETRA Planning: IRA withdrawal or LTCG stock sale – which is better? 2. Katrina Relief Bill and "Indirect" IRA Rollovers.**

16

James E. Connell & Associates
Charitable Estate and Gift Planning Specialists
Box 3335, Pinehurst, North Carolina 28374
Phone 910-295-6800 …. Fax 910-295-6866
"Building Endowments for American Charities"