Financial Alternatives
integrated wealth management

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Thoughts on Giving

One of the wonderful aspects of becoming financially secure and independent is it increases your ability to give and help others. This could be through volunteer work or by financially supporting family members or charities and causes you believe in.

In this issue we cover some of the benefits of giving and how to do it effectively from a financial and tax point of view.

Happiness, Gratitude & Health – 5 Ways We Benefit From Giving

We have all experienced the joy of giving. More recently, academics have been studying its positive effects. Below we describe some of their insights into how we benefit from giving.

1. Giving increases social connection and cooperation. Sociologists have suggested that when you give to others, your generosity is likely to be rewarded by others down the line—sometimes by the person you gave to, sometimes by someone else. These exchanges promote a sense of trust and cooperation that strengthens our ties to others—and research has shown that having positive social interactions is central to good mental and physical health.

2. Giving can be contagious. Studies show that when one person behaves generously, it inspires observers to behave generously later, toward different people.

3. Giving evokes gratitude. Whether you're on the giving or receiving end of a gift, that gift can elicit feelings of gratitude—it can be a way of expressing gratitude or instilling gratitude in the recipient. And research has found that gratitude is integral to happiness, health, and social bonds.

4. Giving can improve our health. A wide range of research has linked different forms of generosity to better health, even among the sick and elderly. Researchers suggest that one reason giving may improve physical health and longevity is that it helps decrease stress, which is associated with a variety of health problems.

Executive Summary

- Giving evokes gratitude, improves our health and makes us happier.
- Giving increases social connection, cooperation and can be contagious.
- From a financial point of view, effective giving maximizes your possible tax deductions.
- Personal Charitable Gift Funds make giving appreciated investments simple and easy.
- Giving to charity from your IRA has significant tax benefits.
- Giving appreciated stock can be a tax efficient way to give money to family members.
- UTMA and 529 accounts offer tax advantaged ways to pay college expenses and provide gifts to children and young adults.

5. Giving makes us happier. A 2008 study by Harvard Business School professor Michael Norton and colleagues found that giving money to someone else lifted participants' happiness more that spending it on themselves (despite participants' prediction that spending on themselves would make them happier).

So whether you volunteer your time, donate money to charity, or help out a family member, your giving may help you build stronger social connections, feel heathier and more grateful, and even jumpstart a cascade of generosity through your community or family. Plus, don't be surprised if you find yourself benefiting from a big dose of happiness in the process as well as reducing your tax burden.

5 Simple, Smart & Tax Efficient Giving Techniques

When Giving to Charities

Personal Charitable Gift Funds: From a financial point of view, giving is all about legally maximizing tax deductions when making a gift. One of the simplest and most convenient ways to do this is to set up a personal charitable gift fund (commonly known as a Donor Advised Fund). These funds can be set up with Fidelity, Schwab, and other institutions.

Once your gift fund is opened, you can transfer in appreciated investments and take a charitable deduction on your income tax return for the full fair market value of the appreciated investments. Why is this better than just giving cash? Because you are able to give away the embedded capital gain that would have to be taxed if you convert the invest-

ment to cash.

Let’s look at a simple example. Assume you wanted to make a $100,000 gift to charity and you could do this with either $100,000 from your bank account or $100,000 worth of XYZ mutual fund shares that you paid $50,000 for. Let’s also assume you wanted to keep your XYZ mutual fund shares for the long-term because you felt they were still an excellent investment.

A smart choice in this situation is to transfer your $100,000 worth of XYZ mutual fund shares to your personal gift fund, and then use the $100,000 in your bank account to buy back the same $100,000 worth of XYZ mutual fund shares.

Here is what you accomplished by doing this. First of all and most importantly, you made the $100,000 gift to charity and saved $40,000 in income taxes (assuming a 40% combined Federal and State marginal tax rate). Second, you eliminated ever having to pay taxes on the $50,000 embedded gain in the $100,000 worth of ZYX mutual fund shares. This saves about $12,500 dollars over the life of the investment assuming a 25% combined tax rate (15% Federal long-term capital gain and 10% State). Third, you have a new cost basis of $100,000 in the same number of shares of XYZ mutual fund which you can now hold for the long term. With this higher cost basis, you could more easily use a tax swap strategy with these shares in the case of a market correction - so as to realize a tax loss and write off income on your tax return.

Other Important Benefits of Using Personal Charitable Gift Funds for Charitable Giving

- You can make larger contributions of stock in years when you have higher taxable income even if you are not ready to make higher charitable contributions in that particular year. The donated amounts simply remain in your personal gift fund until you are ready to give them away.
- Donated amounts can be invested within your personal charitable gift fund and accumulated until you have enough money to make a larger gift to the charity of your choice.
- It is much easier to use a personal gift fund to donate to charities than it is to give stock directly.
- You can open up a fund for as little as $5,000 and from then on you will have no required minimum balance.
- You can encourage giving in the next generation by leaving money in your gift fund for your heirs to give away after you pass away..
- Personal charitable gift funds are simple and easy to use.

Many of our clients have been successfully using personal charitable gift funds for years. If you like the idea, let us know and we’ll be happy to discuss all of this with you in greater detail.

Giving to Charity from Your IRA: If you have an IRA and are over the age of 70 1/2, you are allowed to make charitable contributions that count toward your annual Required Minimum Distribution (RMD) - and there are several income tax benefits for doing so.

If you make a charitable contribution directly from your IRA in an amount that satisfies your RMD, the RMD withdrawal will not appear as income on your tax return. This will reduce your Adjusted Gross Income (AGI) for the year.

Why is this important? It’s important because dozens of tax calculations as well as retiree Medicare premiums are based on your AGI; so a lower AGI, potentially reduces your Medicare premiums and increases many other deductions. Some of the tax and premium calculations affected by AGI include:

- Medical expense deductions for seniors are limited to the amount that exceeds 10% of AGI (7.5% of AGI through 2016).
- Miscellaneous itemized deductions are limited to the amount over 2% of AGI.
- Itemized deductions are generally reduced by 3% of AGI above a threshold.
- Personal exemptions begin to phase out as AGI exceeds a threshold.
- Up to 85% of Social Security income becomes taxable as AGI increases.
- The 3.8% tax on net investment income only applies to AGI above a threshold.
- The cost of Medicare Part B premiums, as well as prescription drug premiums, rise significantly in four steps as AGI increases.

As you can see, IRA charitable contributions provide significant tax benefits to many taxpayers over age 70 1/2. It should be used by most charitably-inclined seniors unless they can receive a greater tax benefit from a gift of substantially appreciated investments that we covered earlier.

Although this strategy has been available over the years, it was finally made permanent in 2015. There are important rules to follow to ensure your IRA charitable donation qualifies for the special tax treatment. For instance, gifts to private foundations and personal charitable gift funds are not allowed. Also, you must actually be 70 1/2 or older on the date of distribution – and not simply turn 70 1/2 that particular year. Be sure to review these rules with your CPA and financial advisor before making a donation from your IRA.

Giving to Family

Appreciated Stock: If you plan to give money to a family member that is in a low income tax bracket, consider giving them appreciated stock. They can sell the stock and pay substantially less tax than you.

Many do not realize that taxpayers in the 15% income tax bracket, actually pay 0% Federal tax on long-term capital

gains until their income exceeds the 15% bracket. Once their taxable income exceeds the 15% bracket, they still only pay 15% Federal tax on the capital gains. A high income taxpayer in California will pay Federal capital gains tax of 23.8% and state tax of 13.3% - for a combined capital gain tax of 37.1%! By giving appreciated stock to family members in a lower tax bracket, you can reduce your own tax burden.

When people think of giving money to family, they often think of giving to their children. Yet with today's sandwich-generation, many of us are helping our kids and our parents. In this case, it's not only the children but also the parents who are in a much lower tax bracket - and giving them appreciated investments instead of cash can save a significant amount of tax.

When giving appreciated investments to children, you have to pay attention to the "kiddie tax" rules. These rules – which affect most dependents up to age 24 – apply a parent's income tax rate to the child at a certain threshold. Still, for older children, gifting appreciated stock can result in significant tax savings.

Under the applicable Kiddie Tax rules this year, children under age 19 and full-time, dependent students under age 24 can have investment earnings of $1,050 tax-free. Investment earnings between $1,050 and $2,100 are taxed at the child's rate; earnings above $2,100 are taxed at the parent's rate.

Uniform Transfer to Minors Act Account (UTMA)*: This is one of the simplest methods of giving money to minor children and for setting aside money for college. An account is opened in the child's name and an adult is named the custodian. Once the child reaches the age of majority, he or she is entitled to the account. The age of majority – typically age 18 or 21 – depends on state law, and can be extended to age 25 in some states like California and Florida.

* South Carolina is the only state that has not adopted the UTMA; instead maintaining the Uniform Gift to Minors Act (UGMA).

There are pros and cons to using UTMA accounts to accumulate money for your kids.

Who should consider using a UTMA account?

- Parents who want a tax-advantaged savings account that they can later give to their child.
- Parents who aren't confident their child will attend college.
- Parents who are not worried about qualifying for college financial aid. UTMA funds will be included in a child's financial needs calculation to a greater degree than 529 account assets.
- Parents who want to be able to use these funds for expenses other than college.
- Parents who are not worried about their child getting control of the account at the age of majority.
- Parents who want to make very large contributions beyond the 529 account funding limits.
- Parents who have already completely funded their child's 529 account.

Who should not consider using a UTMA account?

- Parents who think their child may qualify for financial aid.
- Parents who want to maintain control of the funds and have the option to use any excess funds for a siblings educational expenses.
- Parents who only want to put money away in an account to pay for college expenses and have no intention of ever giving any excess funds directly to their child.
- Parents who may be worried about their child getting access to funds before they have shown the maturity to handle the funds responsibly.

529 Accounts: State sponsored 529 accounts are one of the most tax efficient ways to invest money for future college expenses. Several states offer an income tax deduction or credit for contributions to a 529 plan. And more importantly, all earnings in the account are not just tax deferred but tax free when used for qualified educational expenses. Still, if the withdrawals are used for anything other than educational expenses, the earnings portion of the withdrawal is hit with a 10% penalty and also subject to income tax.

In the event that the initial beneficiary no longer needs the funds for college, parents are able to transfer the accounts to another, related beneficiary, such as a sibling. This flexibility to change the beneficiary of a UTMA does not exist.

When it comes to applying for financial aid, funds in a 529 are considered assets of the parent but funds in a UTMA are considered assets of the student and will be given a higher weight in determining financial aid. So all things being equal when it comes to financial aid applications, having money in a 529 account is better than having money in a UTMA. Like UTMA accounts there are pros and cons to using 529 accounts to save money for your child's educational expenses

Who should consider using a 529 account?

- Parents who are quite certain their children will be attending college.
- Parents who want more control and the flexibility to direct any extra funds left in the 529 to a sibling's educational expenses.
- Parents who want to maximize tax free growth of their college fund assets.
- Parents who feel they might quality for financial aid.
- Parents who want to save money for future educational expenses and also want to maintain 100% control of the funds at all times.
- Parents who are concerned about their child getting control of funds before they are mature enough to responsibly manage these funds.

Who should not consider using a 529 account?

- Parents who are not certain that their kids will incur higher education costs.

- Parents who want to save money on a tax favored basis but want to reserve the right to use the funds for whatever they feel will benefit their child.
- Parents who want to give their child a tax advantaged irrevocable gift that they will gain control of at the age of majority.

Summary

The joy of giving is universal and something we have all experienced. Researchers are discovering that giving has even more positive effects on us than we imagined.

One of the greatest benefits of having a successful financial plan is that it increases your ability to give to others. Work with your CPA and financial advisor to find the right accounts and techniques to maximize the tax benefits you'll receive when you help your family and the charities and causes you believe in.

Thank You for Your Referrals

As always, we want to thank you for the referrals you continue to send us. We appreciate the confidence and trust you have placed in us and we look forward to helping these new clients achieve their goals.

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