Financial Foresight

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Family Gifting: Knowing When to Provide Support

When is it appropriate to say NO to your adult children? One thing I have learned in fifteen years of investment management and financial planning is that baby boomers and their elders are financially generous. While it can feel responsible to provide support, how do you know how much to give and when it is time to draw the line? To answer these questions, you need to consider various issues. This dilemma may come at a time when your parents may also need financial support.

Boomers are likely to have fewer children than the prior generation, and have experienced a strong stock, housing, and job market (the last few years not withstanding). On the flip side, this demographic may be experiencing financial challenges. Often called the "sandwich generation", they find themselves supporting parents and children. Pensions are quickly disappearing, inflation is heating up and interest rates are near record lows on CD's, bonds and other fixed income investments. Combine those concerns with their life expectancy being higher than their parents, boomers and retirees need to be mindful of their cash flow.

About one in five working Americans 45 years and older provide financial support to a parent.[1] Almost one-third of working Americans 45 and older, with a grown child over age 25, pay rent or provide housing for that child.[2] Income is a big factor in determining who gives money to their adult children. When you consider only boomers that earn over $75,000, the average number that provide financial support to their children jumps to 46%.[3] Considering all of the challenges, boomers are trying to determine what is the best amount of support, if any, for adult children and parents.

If you find yourself with this same dilemma, I suggest you answer these questions:

- *Can you afford to provide this financial assistance?*
- *If you can afford it, is it better to provide now or wait until later?*
- *Is this gifting causing you financial or emotional hardship?*
- *Do your children really need the support, or should they adjust their budget to match their own earnings? This may involve lowering their living standard.*
- *Might you become a burden on your children later in life if your resources are depleted? Maybe this money would be better spent buying long term care insurance, adding to savings or paying down debt.*
- *Would your children still want the support if they felt it was causing you a financial burden?*

Imagine a situation where you are providing your two adult children $2,500 each on an annual basis. Can you cover this with income from employment, pensions/social security or investment income and still meet your other personal and financial goals? What if you need to work into retirement to make up these funds? What if you are already retired and are pulling this from your investments? You would need between $150,000-$165,000 of income generating assets to produce this kind of income to cover the gifting and taxes.

While it is certainly true that young adults today probably have larger student loans and higher housing costs, they may have other "things" that you did not have at their age. This might be part of the problem. They may have a nicer car than you did, a bigger house, cell phones, cable TV, and may make frequent stops for expensive coffee. Take a good look at your gifting strategy and compare it to your financial situation to see if changes are required. Here are some ways you can help your children:

- *Talk to your children about their finances and goals.*
- *Help them set up a budget with a program like Quicken. The very process of tracking expenses has a way of reducing discretionary spending.*
- *If they live with you or in a home/condo that you own, consider charging them rent and put this money aside for their future use. This will help them learn to live with this expense and provide them a nice windfall later.*

Looking for Higher Yields

Canadian income trusts, also known as Canadian royalty trusts, are set up similar to real estate investment trusts in the U.S. Both pay out a large percentage of their income which avoids taxation at the corporate level. Trusts can cover a wide range of industries but the most popular fall into the categories of energy, utilities, natural resources and real estate. A strong natural resource-based economy driven by higher prices of these resources have made Canadian trusts popular. (Tax law changes proposed in October of 2006 pose questions about what the structure may look like in 2010 and beyond.) Another reason Canadian trusts may be preferable is many of these trust dividends are taxed at the "qualified rate" (see related article by Ken Nussbaum, CPA) and the dividend yields are often in the 8-12% range. Canadian income trusts can help diversify your portfolio and lessen overall volatility. The main risks include a slowing economy for some of the business categories within the trusts. Another risk is a pullback in commodity prices which could hurt the trust prices and their ability to pay out a current and growing dividend stream. Considering these risks and the current economy, Canadian trusts may be worth looking into for your portfolio.

Your parents will face a whole host of their own issues: Their health may present issues financially as well as physically. Are they house rich but cash poor? If one of them passes on will the surviving spouse be able to handle the bills or estate planning issues? What you can do to help your parents:

- *Review cash value life insurance policies for their cash value if the insurance is no longer needed.*
- *Possibly consider a reverse mortgage. (Both of these decisions should be considered carefully with the help of a financial planner, accountant and/or a professional in that field).*
- *Help your parents managing their bills and cash flow. If you are not available or don't have the time or expertise, go to aadmm.com to find a local Daily Money Manager. These professionals help with paying bills, balancing checkbooks, making bank deposits etc.*

Balancing the needs of all family finances can be challenging but with some planning and sound decisions you can find a solution that helps everyone including yourself. If you decide to help your children financially, carefully consider why and how much. Sometimes the best way to support them isn't financially but by sharing your experience, knowledge and time.

[1]"Retirements Squeezed by Parent, Adult-Child Care," *Financial Advisor*, January 31, 2007.

[2]Ibid.

[3]"Baby Boomers Approach Age 60," n.d., <http://pewresearch.org/assets/social/pdf/socialtrends-boomers120805.pdf>, (20 June 2008)

Special 0% Rate Available for Long-Term Capital Gains and Qualified Dividends

By Ken Nussbaum

The current Federal tax laws provide for a maximum individual tax rate of 15% on qualified dividend income and most long-term capital gains. In 2008, while the 15% cap continues, there is now a 0% rate that is available in certain circumstances. That means that this year, depending on your circumstances, you could have significant income without having to pay any Federal tax whatsoever.

There is some confusion about how the tax brackets work with regard to the special capital gain tax rate. The easiest way to view it is to look at your marginal income tax bracket without regard to the items that are eligible for the special treatment. That is, what is your taxable income before considering any qualified dividends or long-term capital gains. If after adding your qualified dividends and long-term capital gain you are still not in the 25% marginal income tax rate, then you enjoy a 0% rate on all of your qualified dividends and eligible long-term capital gains. Otherwise, the 0% rate will apply up to the point at which you reach the 25% marginal income tax rate, after which the 15% rate will apply on to the qualified dividends and long-term capital gains. The chart below summarizes, at various filing statuses, the amount of taxable income you could have - before consideration of your qualified dividends and long-term income - and still be eligible for the 0% preferential rate for 2008.

Understanding the mechanics is important. You may be able to plan around the available rate and, to the extent that you are able to take advantage of the 0% rate, you may be able to save a significant amount of income tax. Perhaps this is best explained by example.

Suppose, for instance, that a retired married couple anticipates 2008 income of $25,000 in Social Security and $45,000 in investment income. Depending on the makeup of their investment income, they could expect a Federal Income Tax liability of anywhere from $0 to nearly $5,600. That is, if the $45,000 is, for instance, all interest or other ordinary income that doesn't enjoy a preferential rate, the expected tax burden would be nearly $5,600. On the other hand, if the $45,000 were all in qualified dividends or long-term capital gains, their tax bill would be $0.

Taxable Income Limits - 0% Rate

Married, Filing Jointly*	$65,100
Single	$32,550
Head of Household	$43,650

*and qualifying widow(er)

This is merely one brief example, designed to point out that your investment choices can dramatically impact your tax bill. It is also intended to make you realize that you have the ability to use the tax laws to your advantage. While the special tax rate is scheduled to expire after 2010, bear in mind that there is the possibility that it will be extended.

It may be well worth the effort to look to realign your portfolio to allow you to take advantage of the favorable tax laws. Everyone's needs are unique; you should ensure that your portfolio is properly designed to help you reach your specific goals and objectives. {If you haven't spoken to Don lately, don't wait until it is too late to make decisions that could help you to save significant tax dollars this year.}

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