next nest

FAIRMAN GROUP
FAMILY OFFICE

WHEN LIFE HAPPENS: YOUR CHILDREN START HAVING CHILDREN

If you are ready to retire, entering a second career, caring for aging parents, or have adult children, you won't want to miss our series about the financial implications, opportunities and gotchas regarding life challenges.

NEXT NEST SERIES, VOLUME 2

OUR FICTITIOUS FAMILY, THE CARLSONS

In our last story about James, age 60, a VP and Director at a publicly-held company in Radnor and his wife, Jeanne, age 58, owner of a small Public Relations firm in Wayne, we focused on the pros and cons of remodeling their Main Line home vs. moving to Center City. Now the Carlsons are about to become grandparents and are considering all the financial consequences for themselves, their children, and future grandchildren.

The Carlsons' oldest son was married last year, and the newlyweds are now expecting their first child. James and Jeanne are ecstatic about the news and would like to help. Their daughter-in-law was just promoted and has a great career, while their son is between jobs and willing to be a stay-at-home parent—at least for a while.

- Should they help their son and daughter-in-law purchase a home? If so, what are their choices in terms of ownership and financing?
- Should they set up a vehicle to help their future grandchild with education or other expenses?

One major issue that many parents may not consider is: With three adult children, helping the older son and future grandchild, may be setting a precedent that they may feel obligated to follow with all their children and future grandchildren. Considering the Carlsons' age and the fact that they have three adult children, they likely will be grandparents several times over.

Keeping with our story, this is the future child of the Carlsons' oldest son. This son did not go to college, so the parents want to create a financially equitable situation, accounting for the fact that they paid for 100% of their other children's college

education. While understandable, the Carlsons should keep in mind the potential needs of future grandchildren, and most importantly their obligation to financially ready themselves for retirement as a top priority. We would advise them to exercise caution, not go overboard with the first grandchild and not jeopardize their own financial security in any way. There are certainly other ways to "financially balance" their oldest son later in life when the Carlsons themselves are more set or even through their will and estate arrangements.

HELPING WITH THE PURCHASE OF A HOME

To help with the down payment or purchase of a home, the Carlsons could help their oldest son and his wife by gifting them money within the annual gift exclusion limit. They could 'gift' them up to $60K without the need to file a gift tax return ($15K each from James and Jeanne to both their son and daughter-in-law). Looking at starter homes in the Philadelphia suburbs, a 20% down payment on a $300K home puts them right at that amount. The young couple would own the home and be responsible for the mortgage under this scenario, which seems reasonable. Furthermore, there are no income tax ramifications to the son and daughter-in-law—the money is a gift!

For 2018, the estate and gift tax lifetime exemptions are $11.18 million per individual, up from $5.49 million in 2017. That means an individual can leave $11.18 million to heirs and pay no federal estate or gift tax. A married couple will be able to shield north of $22 million from federal estate and gift taxes. And the annual gift exclusion amount is $15,000 for 2018—up from $14,000 where it's been stuck since 2013.

Other options regarding helping your child with a home purchase are fraught with potential problems. If the parents loan money to their children, what is the expectation for repayment? Who will draft the mortgage document? The mortgage rate must not be less than the Applicable Federal Rate for the respective term. What happens if the son and his wife miss a payment or a series of payments? Would the money be forgiven and turn into a gift over time?

HELPING WITH EDUCATION EXPENSES

Once the grandchild is born, you may want to set aside money for the grandchild's benefit. One common option is a UGMA (Uniform Gift to Minors Act) or UTMA (Uniform Transfer to Minors Act) Custodial Account. This type of account can be set up at any bank or financial institution and is used to hold and protect assets for minors until they reach the age of majority in their state (21 years of age in PA). These accounts can contain cash, CDs (Certificate of Deposit) or securities such as stocks, bonds, and mutual funds. Because the assets are considered the property of the minor via gift, any income generated in the account is sourced to the minor for tax purposes. This is advantageous to some extent but the "kiddie tax" rules apply to higher amounts of income. With UGMA/UTMAs it is critical to remember that once the grandchild turns 21, the money is theirs and can be used at their discretion for any purpose.

A great option for saving for education is a Section 529 Savings Plan. There are two types of Section 529 plans: savings accounts and prepaid tuition plans.

- With either option, deposits are considered to be 'gifts' to the beneficiary–the grandchild.
- You can gift up to 5 years at once (an acceleration)–superfund them–(so the Carlsons could put up to $150K in), as soon as the grandchild has a social security number. The money grows tax free if used for qualified education purposes!
- Since the Carlsons are PA residents and both work, they would get to deduct up to $30K maximum (on their PA return) regardless of the superfund option. The Carlsons could also fund accounts (at any point) with cash or by rolling over an existing UGMA/UTMA account.

The major advantage of 529 Plans is that distributions are not taxed if the money is used for "Qualified Education Expenses".

QUALIFIED EDUCATION EXPENSES

- Tuition
- Mandatory fees
- Required textbooks, supplies and equipment (for college expenses only)
- If used primarily by the beneficiary during the time the beneficiary is enrolled at an eligible educational institution, the following are included: Computer or peripheral equipment; Computer software; Internet access and related services
- Room and board during any academic period during which the beneficiary is enrolled at least half-time in a degree, certificate or other program that leads to a recognized educational credential awarded by an eligible educational institution (for college expenses only)
- Special needs services for a beneficiary enrolled at a college or university (for college expenses only)
- Paying off a student loan is not considered a qualified expense

Thanks to the new tax law, some money can now be used for K-12 expenses (up to $10K per year) – this is a huge change as K-12 education institutions were not included under previous law. Now, most private elementary schools, high schools, community colleges, public and private four-year colleges, universities and vocational schools in the United States are eligible educational institutions. Some foreign institutions are also eligible. To find out if a school is eligible, go to the Department of Education's website: https://fafsa.ed.gov/FAFSA/app/schoolSearch.

Providing financial resources for special needs children is another aspect altogether. Special needs trusts can be formed and somewhat new accounts called ABLE (Achieving a Better Life Experience) accounts are available. ABLE accounts fall under Section 529 of the Internal Revenue Code and allow investments to grow tax-free if used for general care and needs.

IF YOU FIND YOURSELF IN A FINANCIAL SITUATION SIMILAR TO THE CARLSONS, LET US HELP YOU EXPLORE THE OPTIONS THAT MAKE THE BEST SENSE FOR YOU.

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