Financial focus

Clark Financial Planning Services LLC

WINTER 2019

In This Issue

Giving: How to Do the Most Good Without Disrupting Your Financial Plan
- Frank J. Corrado, CPA, CFP®

The Three Ghosts of Gift Tax
- Wendy Marsden, CFP®, CPA, MS

Your New Year's Resolutions Are in Reach: How the Right Mind-set Can Set You up for Financial Success
- Steven Clark, CFP®, EA

Pay Down Debt or Save for Retirement?
- Mike Skolnick, CPA, PFS

Giving: How to Do the Most Good Without Disrupting Your Financial Plan

Frank J. Corrado, CPA, CFP®
Holmdel, NJ

Many studies have shown that charitable giving provides greater happiness than buying more stuff. Eventually, you get used to your fancy new car, and the enjoyment it provides may fade—though if you're spending with purpose, it shouldn't.

Even if that big purchase thrill does fade, there's plenty of anecdotal evidence and actual scientific studies to assure us that giving forges feelings of connectedness and community that don't fade away. Incorporating charitable giving into your financial plan is a great way to make sure that your generosity is aligned with the things that are most important to you. Some forethought about these key issues will also make sure that your good intentions don't throw off the rest of your long-term planning:

Have a Purpose
The most effective charitable giving is thoughtful and intentional. It may be helpful for you and your spouse to ask yourselves some questions that will narrow your focus, such as:

- Do we want to give to a national or local cause?
- Are there pressing issues in our community that we feel we can help impact?
- Do we have any personal connections to causes, such as medical research or support for the arts?
- Do we want to support friends or family by contributing to causes that impact their lives or fulfill their passions?
- Do we want to support a religious organization such as our church?
- Are our charitable impulses motivated by ongoing problems such as education or homelessness, or would we rather position ourselves to react to events such as natural disasters?

Do Your Homework
Once you've settled on a cause, do some research on potential recipients. Visit the local nonprofit you'd like to support and meet with its leadership team. Is the organization running itself responsibly? Are there good, competent people in charge? Will these people get the job done? Don't sink your money into a well-intentioned black hole.

If you're looking to give to a national organization, keep in mind that even some of the biggest names have come under fire lately from watchdog groups for misusing donations. Make sure you're giving to an organization that's doing what it promises to do with your money.

All not-for-profit organizations must be registered with the IRS and many will have their tax form, called a 990, available for review. You can also review organization profiles on Charity Navigator and Guidestar for more information.

And if you know anyone else who has been supporting an organization you're researching, take the time to speak with them about their experience.

Beware the Internet
Whenever something bad happens in the world, our inboxes and social media are flooded with donation links. **Read before you click**. Be especially wary of crowd-funded campaigns on sites like GoFundMe. The cause may sound worthy, but these sites do not provide meaningful oversight on every campaign. Your money could be going to a cause, or it could be going straight into a

Continued on page 2

The Three Ghosts of *Gift Tax*

Wendy Marsden, CFP®, CPA, MS
Greenfield, MA

Gifts are not taxable income. However, they can come back to haunt you! Be aware of the three ghosts of gift tax.

The first ghost will come if you are applying for a mortgage and the bank is trying to determine where you're getting the money for your down payment. They want to make sure you're not taking out a side loan (and are hence a worse risk to them because of your greater debt burden). If you are going to use gift money to buy a house, they will want a letter from the donor stating it's a gift and **not** a loan.

The second ghost will come wanting evidence of a gift to prove that it is not taxable income. Once I had a self-employed person get audited by the IRS. The first thing the IRS does with a self-employed person's audit is add up all the deposits into their bank accounts to see if it's more than the income they claimed. The IRS came back and said his deposits into his bank account were $8,000 more than he showed on Schedule C. In fact, they said, he'd left off all his August income. He claimed he didn't even work that August! Curious, I asked why he hadn't worked. He said it was because he'd gotten married. Aha! Those deposits were wedding gifts, not subject to income taxes! Happily, we could prove he'd really been married then, and that a large deposit went to pay for the wedding—it really was from his parents.

The third gift tax ghost comes for the paperwork, which can be a bit complex. The first thing to know is that you don't have to do anything if the gift was less than some "de minimis" annual exclusion. De minimis literally means "so little we can disregard it." The annual exclusion was $10,000 for many, many years, and started to climb with inflation a few years back. For 2018 it's $15,000 per recipient. So, you can give $15,000 to your daughter and $15,000 to your son and $15,000 to your son-in-law and $15,000 to your daughter-in-law… and if you're married your spouse can do the same thing. That's $15,000 all-in, including Christmas presents (there are some exceptions surrounding payments made directly to a hospital or college).

If you ***get*** a gift of whatever amount, it's all cool. Make a note in your checkbook, maybe copy the check for your tax files, and send a thank you note (I didn't have to tell you that, I'm sure). You can stop reading here. Fa la la la, enjoy your day!

The problem is if you ***give*** a gift over the annual exclusion rate. Now you have wandered into the territory of estate taxes—the tax you pay when you transfer money from one generation to another. Here's how it works.

Imagine you've got a net worth of $12,000,000 and you're feeling a bit peaked. Imagine also that you know that the estate tax exemption happens to be $11,180,000 right now. You gather your two beloved children to your bedside and say "here, each of you, have $1,000,000 each." You bring your net worth down to $10,000,000 and then die the next day. Did you cheat the tax man? No! Because gifts over the annual exclusion amount get added back to your estate [transfer] tax return. In fact, all the gifts you made in your entire lifetime above the "de minimis" amount get added back to your estate tax return. Depending on the estate tax exclusion level in the year you die, the gifts you gave may or may not cause you to have to pay any actual tax, but all the gifts you ever made eat away at a lifetime exclusion that isn't actually knowable until the day you die; estate tax exclusions shift around a lot depending on who's in control of Congress.

How do gifts you made in 1997 get added to your estate transfer return when you die in 2047? Paperwork! Really dreadful paperwork that literally follows you to the grave. When you give a gift over [whatever the annual exclusion is that year], you must file a gift tax return and tuck it into a folder called "Estate of [Your Own Name]". It's not a hard return to do, but you'll probably pay an accountant a couple of hundred dollars to do it, and you'll be stuck with a folder in your filing cabinet that your heirs/accountants/lawyers should know about when you die.

There you have it: give gifts of above $15,000 a year per person per recipient and you're saddled with serious paperwork requirements. It's not (usually) a tax, but it's taxing nonetheless. If the ghosts of gift tax come for you this year, you can be ready for them.

Giving: How to Do the Most Good Without Disrupting Your Financial Plan (Cont.)

scam artist's pocket. You'll never know for sure unless you know the person organizing the campaign.

In this, as in other opportunities such as using robo-advisors to help make investment decisions, our recommendation is always the same. Absolutely use tech tools to empower and enable you to reach your goals, but never substitute tech tools for guidance and counsel from human professional partners who are invested in your success.

Find Out What Will Do the Most Good
There's more than one way to give. Yes, mission-driven not-for-profits need financial support to do their good work, and if, after self-reflection and doing your research you do write that check, you should feel great about your support.

But maybe the local adult literacy center needs volunteer tutors as much as it needs money. Perhaps you'd feel more fulfilled helping out at your church's food bank than from simply writing a check. Taking a more active role in a cause that's important to you might be the most valuable thing you can give.

Know Your Limits
Especially as you near retirement age, your giving should be a planned part of your budget. Don't make a large one-time contribution that's going to force you to dip into an emergency savings fund. Don't sign up for a recurring gift that's going to put a strain on your monthly bills. If you can't give as much money to a cause as you'd like, think about supplementing a smaller contribution with regular volunteering.

It's great that you want to use your money to try to make the world a better place, but your comfort and happiness are important too. When in doubt, let your core values be your guide. Apply the same principle to your giving as you do to the rest of your life-centered financial plan: use the money you have to get the best life possible. With a little planning, you'll make life better for those around you as well.

Your New Year's Resolutions Are in Reach: How the Right Mindset Can Set You up for Financial Success

Steven Clark, CFP®, EA
Coconut Creek, FL

For many people, the new year means setting goals. I believe that if you are able to focus on what you can consistently control, develop a plan around those things, and stick to the plan over the long term, you will sleep better and have a better chance of reaching your financial goals. You and I cannot control the stock market, the economy, or major world events, but by focusing on our mindset we can have a level of control over our investments. My ***Five-by-Five formula*** for reaching your financial goals includes five behavioral and five technical principles. Today we'll look at the first five things you can control—the behavioral principles.

Most People Focus on the Wrong Things
I have learned that many people focus on the wrong things when putting together their savings and investing plan. Some common mistakes are:

- Having a plan that does not fit their unique financial situation and goals. Often, they simply do what the crowd is doing.
- Not having SMART goals, which are **S**pecific, **M**easurable, **A**chievable, **R**ealistic, and **T**ime-bound. No need to overanalyze, but thinking through goals, writing them down, and having some parameters attached to them increases the odds of success.
- Setting an unrealistic target rate of return as their primary focus. A financial plan should start by identifying goals, not rates of return.
- Trying to time the markets based on things such as economic forecasts, earnings reports, and political events.
- Not understanding their risk capacity and risk tolerance.
- Making a high-risk bet by putting all their money into the stock of one company or a single business venture.
- Wanting to get rich quick without understanding that most people can build enough wealth over a lifetime by investing and saving.
- Focusing too much on the 24-hour news cycle and making emotional decisions based on it.
- Getting lost in the weeds while forgetting to focus on the big picture.

The Five Behavioral Principles

Control Emotions
Bailing on a financial plan and selling investments when markets go down is a sure-fire way to fail at reaching financial goals. The same can be said when markets are rising—many people become afraid they will miss out on huge returns. They increase their exposure to equities (buying high) without regard to their risk capacity and risk tolerance.

Have Patience
Understanding that reaching financial goals takes time and is not achieved overnight is crucial to succeeding. People who want success quickly tend to take on too much risk. Then when something goes wrong, they bail on their financial plan.

Have Faith Grounded in Knowledge
One must have faith in the future to successfully invest and save When an investor purchases shares in an asset such as a mutual fund or ETF, they must believe in capitalism, believe companies will grow and earn more money in the future, and believe our country will thrive and prosper. This faith must be grounded in knowledge about how the markets and economies work. You do not need to get a college degree in finance or economics, but understanding the basics will help you stick to a plan.

Have Discipline to Stick to a Plan
A financial plan is a road map for reaching financial goals. For a plan to work, you must stick to it in market ups and downs, year in and year out. This is not to say a plan is never adjusted. However, adjustments should be made deliberately and based on reason and thought, not emotions.

Pay Yourself First
This might be the most important behavioral principle and one of the hardest to implement. In order to build wealth, you must live on less than you earn. It is as simple as that. To live on less than you earn, you must set aside a portion of your earnings every time you are paid. The trick is that you have to treat it like your most important bill and make the payment to your savings as soon as you are paid. A mistake that many people make is to wait until the end of the month and plan to save whatever is left over. The problem with this approach is that for most people, there will never be any money left over at the end of the month because they always find a reason to spend it all.

A person's behavior is the most important factor that will determine whether they succeed or fail at reaching their financial goals. Understanding and managing these five behavioral principles are crucial. Can you change your mindset by setting savings and investing goals that will lead to financial success?

Pay Down **Debt** or Save for **Retirement**?

Mike Skolnick, CPA, PFS
San Diego, CA

You can use a variety of strategies to pay off debt, many of which can cut not only the amount of time it will take to pay off the debt but also the total interest paid. But like many people, you may be torn between paying off debt and saving for retirement. If you're not sure you can afford to tackle both at the same time, here are some of the factors you should consider.

Rate of Investment Return versus Interest Rate on Debt
Probably the most common way to decide whether to pay off debt or to make investments is to consider whether you could earn a higher after-tax rate of return by investing than the after-tax interest rate you pay on the debt. For example, say you have a credit card with a $10,000 balance on which you pay nondeductible interest of 18%. By getting rid of those interest payments, you're effectively getting an 18% return. That means your money would generally need to earn an after-tax return greater than 18% to make investing the smarter choice. That's a pretty tough challenge even for professional investors.

Bear in mind that investment returns are anything but guaranteed. In general, the higher the rate of return, the greater the risk. By contrast, the return that comes from eliminating high-interest-rate debt is a sure thing.

An Employer's Match May Change the Equation
If your employer matches a portion of your workplace retirement account contributions, that can make the debt versus saving decision more difficult. Let's say your company matches 50% of your contributions up to 6% of your salary. That means that you're earning a 50% return on that portion of your retirement account contributions.

If surpassing an 18% return from paying off debt is a challenge, getting a 50% return on your money simply through investing is even tougher. Plus, you know in advance what your return from the match will be; very few investments can offer the same degree of certainty. That's why many financial experts argue that saving at least enough to get any employer match for your contributions may make more sense than focusing on debt.

Don't forget the tax benefits of contributions to a workplace savings plan. By contributing pretax dollars to your plan account, you're deferring anywhere from 10% to 39.6% in taxes, depending on your federal tax rate.

Your Choice Doesn't Have to Be All or Nothing
The decision about whether to save for retirement or pay off debt can depend on the type of debt you have. For example, if you itemize deductions, the interest you pay on a mortgage is generally deductible on your federal tax return. Let's say you're paying 6% on your mortgage,18% on your credit card debt, and your employer matches 50% of your retirement account contributions. You might consider directing some of your resources to paying off the credit card debt and some toward your retirement account to get the full company match while continuing to pay the tax-deductible mortgage interest.

Time is your best ally when saving for retirement. If you wait to start saving until your debts are completely paid off, you might never start saving. It might also be easier to address both goals if you can cut your interest payments by refinancing that debt. For example, you might be able to consolidate multiple credit card payments by rolling them over to a new credit card or a debt consolidation loan with a lower interest rate.

Bear in mind that even if you decide to focus on retirement savings, you should make sure that you're able to make at least the monthly minimum payments owed on your debt. Failure to make those minimum payments can result in penalties and increased interest rates.

Other considerations
When deciding whether to pay down debt or to save for retirement, make sure you consider the following factors:

• Having retirement plan contributions automatically deducted from your paycheck eliminates the temptation to spend that money on things that might make your debt dilemma even worse.
• Remember that if your workplace savings plan allows loans, contributing to the plan not only means you're helping to provide for a more secure retirement but you're also building savings that could potentially be used as a last resort in an emergency.
• If you focus on retirement savings rather than paying down debt, make sure you're invested so that your return has a chance of exceeding the interest you owe on that debt. While your investments should be appropriate for your risk tolerance, if you invest too conservatively, the rate of return may not be high enough to offset the interest rate you'll continue to pay.

All content provided by members of: