

the Connection

A Quarterly Review

1st Quarter 2016

A GIFT FOR THEIR FUTURE

Two common questions we hear are; what is the best way to gift money to younger generations? and what is the best way to educate teens and young adults about investing? You can accomplish both by setting up and funding a Roth IRA for them. Time is one of the most powerful assets any investor has due to the snowballing effect of compounding. Starting early, developing good savings habits, and working together to select the investments is a great way to teach the principals of disciplined investing that will really pay off in the long run.

Anyone can contribute after tax dollars to a Roth IRA up to the amount of the owners earned income. (Earned income does not include dividend & interest income or income from partnerships or property.) This means that if a young person has earned income from a part time job their parents, grandparents, aunts, uncles, or family friends can fund a Roth IRA for them and create a lifetime gift. The yearly contribution limit is the smaller of \$5,500 or the young person's compensation.

As an example: If a student earns \$2,300 from a part time job, up to \$2,300 can be contributed to a Roth IRA. If a recent grad earns \$25,000 up to \$5,500 can be contributed.

Roth IRAs enjoy a rather unique tax treatment. Withdrawals are treated as a "return of contribution" first, which is never taxed or penalized. Conversion money is second and earnings are third. For earnings and conversion money to come out tax free they must be held in the account for 5 years. Those funds are also subject to an early withdrawal penalty of 10% if taken before age 59 ½.

Two features that make Roth IRAs very attractive for young investors are:

First time home purchase withdrawal exemption: Up to \$10,000 of earnings can be withdrawn for a first time home purchase without penalty and if held for 5 years without tax. According to IRS rules, first home purchase assets can be withdrawn for the account holder, or for the account holder's children or grandchildren.

For college expenses: One savings vehicle that is often overlooked as a way to fund a child's college education is a Roth IRA. With a little planning, they can be an ideal source for funding a loved one's higher education.

Most people think of the Roth IRA as a terrific method to save for retirement—which it is—but it can also be a great tool to help you cover Junior's university tab. Uncle Sam allows penalty-free withdrawals from a Roth IRA for assets earmarked toward college expenses for the account holder, or for the account holder's spouse, children, and grandchildren. Any amount of earnings withdrawn for Postsecondary education expenses are penalty free. For most folks who are sending their kids off to college, only the contribution portions of their Roth IRA balances can be withdrawn tax-free. Any earnings in the account will be taxable for people under 59, as well as for those over 59½ who haven't held the Roth for at least five years.

What I really like about the Roth IRA is the flexibility it offers over the 529 plan.

The main drawback of using a Roth IRA to save for college is the lower contribution limits. Further, in order to qualify to make a full contribution to a Roth IRA, your income must be less than \$184,000 for married couples or less than \$117,000 for singles in 2016.

To sum up: As a Grandparent, you could create a Roth in your child's name (and one for their spouse as well, provided the couples AGI is under \$184,000) that they can use to pay for their children's college. You can also create a Roth in your grand child's name up to the amount of their earned income. As a parent you can create an account for yourself to use for education expenses and you can create an account for your child if they have earned income.

THE ACT OF GIVING

Below is an updated list of some organizations our clients are helping today. Please let Barbara know the names of organizations you care about and we will include them on list next quarter. Send email to bcorley@gencappm.com.

All Local Food Banks

www.sfmfoodbank.org

www.shfb.org

www.foodbankccs.org

Image for Success

www.imageforsuccess.org

Maya's Music Therapy

www.mayasmusic.org

Canal Alliance

www.canalalliance.org

Friends of the Urban Forest

www.fuf.net

Guide Dogs for the Blind

www.guidedogs.com

Doctors without Borders

www.doctorswithoutborders.org

The Nature Conservancy

www.nature.org

National Kidney Foundation

www.kidney.org

Guide Dogs of America

www.guidedogsofamerica.com

Golden Gate National Parks Conservancy

www.parkconservancy.org

Fine Arts Museums of San Francisco

www.famsf.org

Canine Companions for Independence

www.cci.org

Alzheimer's Association

www.alz.org

The Foundation for Rotary International

www.therotaryfoundation.org