The Wealth Architect

Helping you build your financial future.

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Dear Friends,

Welcome to the September 2016 issue of The Wealth Architect.

Did you know? September was the month when band aid was invented ... the month when the name “United States” came into existence, replacing the original name, United Colonies ... and is National Hispanic Heritage Month.

Fun and serious facts aside, read The Wealth Architect for valuable information. As always, if you have any questions or concerns, please feel free to contact us.

Sincerely,
The Professionals at Armao LLP

September 2016

ARMAO LLP
CERTIFIED PUBLIC ACCOUNTANTS

Substantiating Your Charitable Gifts

When you claim a federal income tax deduction for charitable contributions, you must substantiate the contributions by maintaining certain records. The records must establish the charity to whom the gift was made, the amount of cash or the type and value of other property donated to charity, whether anything was received in consideration for the contribution, and certain other requirements. The records needed generally depend on the type and value of the property donated; there may be some overlap in requirements. In general, do not attach the records to your income tax return. Keep the records so that you can provide them to the IRS if requested to do so.

Cash contributions

In order to claim a charitable deduction for any contribution of cash, a check, or other monetary gift, you must maintain a record of such contributions through a bank record (such as a cancelled check, a bank or credit union statement, or a credit card statement) or a written communication (such as a receipt or letter) from the charity showing the name of the charity, the date of the contribution, and the amount of the contribution. If you make charitable contributions through payroll deductions, you generally may substantiate the charitable deduction using the charity's pledge card along with either a pay stub, a Form W-2, or some other employer-furnished document showing the amount withheld and paid to charity. If you make a single contribution of $250 or more by payroll deduction, the pledge card or a document from the charity must state that no goods or services were provided in return for the payroll deduction.

All contributions of $250 or more

If you claim a charitable deduction for any contribution of $250 or more, you must substantiate the contribution with a contemporaneous written acknowledgment of the contribution from the charity. The acknowledgment must contain the name of the charity, the amount of any cash contribution, and a reasonably detailed description of any non-cash contribution. The acknowledgment must also include either (1) a statement that no goods and services were provided by the charity in return for the contribution, (2) a good-faith estimate of the value of such goods and services (these reduce the amount of the charitable deduction), or (3) a statement that the goods and services were token benefits or consisted entirely of insubstantial membership benefits or intangible religious benefits. The acknowledgment is considered contemporaneous if you receive it by the earlier of the date on which you file your tax return for the year of the contribution or the due date (including extensions) for the return.

Noncash contributions

If you make any noncash contributions, you must generally get a receipt from the charitable organization with the name of the charitable organization, the date and location of the contribution, and a reasonably detailed description of the property. You must also keep a reliable written record showing the name and address of the charitable organization, the date and location of the contribution, a reasonable detailed description of the property, the fair market value of the property (and how it was determined), the adjusted basis of the property, the amount claimed as a deduction, and the terms of any conditions attached to contribution of the property.

If the value of the contribution is $250 or more, you must also substantiate the contribution with a contemporaneous written acknowledgment of the contribution from the charity as described previously.

If the value of the contribution is over $500, your records must also include how you got the property (e.g., purchase, gift, inheritance, or exchange), when you got the property, and the cost or other basis of the property (including any adjustments).

If you claim a deduction of over $5,000 for a noncash charitable contribution of one item or a group of similar items, you must also obtain a qualified written appraisal of the donated property from a qualified appraiser.

The Importance of Saving for Retirement at a Young Age

Millennials and Retirement Planning

A September 2015 study found that 60% of millennials think planning for retirement is harder than sticking with a diet and exercise plan. By contrast, 61% of baby boomers think dieting/exercising is harder, and 51% of Gen Xers think retirement planning is harder.

Source: "Will Millennials Ever Be Able to Retire?" Insured Retirement Institute and The Center for Generational Kinetics, September 2015

If you're an adult in your 20s, you are entering an exciting stage of life. Whether you've just graduated from college or are starting a new career, you will encounter many opportunities and challenges as you create a life of your own.

As busy as you are, it's no surprise that retirement may seem a long way off, especially if you're just entering the workforce. What you may not realize, however, is that there are four very important advantages to begin planning and saving for retirement now.

1. Money management skills

Now that you're out on your own, it's important to start taking responsibility for your finances little by little. Part of developing financial responsibility is learning to balance future monetary needs with present expenses. Sometimes that means saving for a short-term goal (for example, buying a new car) and a long-term goal (for example, retirement) at the same time.

Once you become used to balancing your priorities, it becomes easier to build a budget that takes into account both fixed and discretionary expenses. A budget can help you pursue your financial goals and develop strong money management skills. If you establish healthy money habits in your 20s and stick with these practices as you grow older, you'll have a major advantage as you edge closer to retirement.

2. Time on your side

When you're young, you have the benefit of time on your side when saving for long-term goals (like retirement). You likely have 40-plus years ahead of you in the workforce. With that much time, why not put your money to work using the power of compounding?

Here's a hypothetical example of how compounding works. Let's say that at age 25, you start putting $300 each month into your employer's retirement savings plan, and your account earns an average of 8% annually. If you continued this practice for the next 40 years, you would have contributed $144,000 to your account, accumulating just over $1 million by the time you reached age 65. But if you waited 10 years until age 35 to start making contributions to your plan, you would have accumulated only $440,000 by age 65.

Note: This hypothetical example of mathematical compounding is used for illustrative purposes only and does not represent any specific investment. Taxes and investment fees are not considered. Rates of return will vary over time, especially for long-term investments. Investments offering the potential for higher rates of return also involve a higher degree of risk. Actual results will vary.

3. Workplace retirement benefits

If your employer offers a workplace retirement plan such as a 401(k) or 403(b), you may find that contributing a percentage of your salary (up to annual contribution limits) will make saving for retirement easier on your budget. Contributions are typically made on a pre-tax basis, which means you can lower your taxable income while building retirement funds for the future. You aren't required to pay any taxes on the growth of your funds until you take withdrawals. Keep in mind that distributions from tax-deferred retirement plans are taxed as ordinary income and may be subject to a 10% federal income tax penalty if withdrawn before age 59½.

Depending on the type of plan, your employer may offer to match a percentage of your retirement plan contributions, up to specific limits, which can potentially result in greater compounded growth and a larger sum available to you in retirement.

If you don't have access to a workplace retirement savings plan, consider opening an IRA and contribute as much as allowable each year. An IRA may offer more investment options and certain tax advantages to you.

If you have both a workplace plan and an IRA, one strategy is to contribute sufficient funds to your workplace plan to take advantage of the full company match, and then invest additional funds in an IRA (up to annual contribution limits). Explore the options available to find out what works best for your financial situation.

4. Flexibility of youth

Although there's a good chance you have student loans, you probably have fewer financial responsibilities than someone who is older and/or married with children. This means you may have an easier time freeing up extra dollars to dedicate toward retirement. Get into the retirement saving habit now, so that when future financial obligations arise, you won't have to fit in saving for retirement too--you'll already be doing it.

Five Things to Know About Inherited IRAs

You are generally not the "owner" of an inherited IRA. The practical result of this fact is that you can't mix inherited IRA funds with your own IRA funds, and you can't make 60-day rollovers to and from the inherited IRA. Spousal beneficiaries, however, may be able to assume actual ownership of an inherited IRA.

****If the traditional IRA owner died after age 70-1/2 and did not take an RMD for the year of his or her death, you must also withdraw any remaining RMD amount for that year.***

When an IRA owner dies, the IRA proceeds are payable to the named beneficiary--or to the owner's estate if no beneficiary is named. If you've been designated as the beneficiary of a traditional or Roth IRA, it's important that you understand the special rules that apply to "inherited IRAs."

It's not really "your" IRA

As an initial matter, while you do have certain rights, you are generally not the "owner" of an inherited IRA. The practical result of this fact is that you can't mix inherited IRA funds with your own IRA funds, and you can't make 60-day rollovers to and from the inherited IRA. You also need to calculate the taxable portion of any payment from the inherited IRA separately from your own IRAs, and you need to determine the amount of any required minimum distributions (RMDs) from the inherited IRA separately from your own IRAs.

But if you inherited the IRA from your spouse, you have special options. You can take ownership of the IRA funds by rolling them into your own IRA or into an eligible retirement plan account. If you're the sole beneficiary, you can also leave the funds in the inherited IRA and treat it as your own IRA. In either case, the IRA will be yours and no longer treated as an inherited IRA. As the new IRA *owner* (as opposed to *beneficiary*), you won't need to begin taking RMDs from a traditional IRA until you reach age 70½, and you won't need to take RMDs from a Roth IRA during your lifetime at all. And as IRA owner, you can also name new beneficiaries of your choice.

Required minimum distributions

As beneficiary of an inherited IRA--traditional or Roth--you must begin taking RMDs after the owner's death.* In general, you must take payments from the IRA annually, over your life expectancy, starting no later than December 31 of the year following the year the IRA owner died. But if you're a spousal beneficiary, you may be able to delay payments until the year the IRA owner would have reached age 70½.

In some cases you may be able to satisfy the RMD rules by withdrawing the entire balance of the inherited IRA (in one or more payments) by the fifth anniversary of the owner's death. In almost every situation, though, it makes sense to use the life expectancy method instead--to stretch payments out as long as possible and take maximum advantage of the IRA's tax-deferral benefit.

You can always elect to receive more than the required amount in any given year, but if you receive less than the required amount you'll be subject to a federal penalty tax equal to 50% of the difference between the required distribution and the amount actually distributed.

More stretching...

What happens if you elect to take distributions over your life expectancy but you die with funds still in the inherited IRA? This is where your IRA custodial/trustee agreement becomes crucial. If, as is sometimes the case, your IRA language doesn't address what happens when you die, then the IRA balance is typically paid to your estate--ending the IRA tax deferral.

Many IRA providers, though, allow you to name a successor beneficiary. In this case, when you die, your successor beneficiary "steps into your shoes" and can continue to take RMDs over your remaining distribution schedule.

Federal income taxes

Distributions from inherited IRAs are subject to federal income taxes, except for any Roth or nondeductible contributions the owner made. But distributions are never subject to the 10% early distribution penalty, even if you haven't yet reached age 59½. (This is one reason why a surviving spouse may decide to remain as beneficiary rather than taking ownership of an inherited IRA.)

When you take a distribution from an inherited Roth IRA, the owner's nontaxable Roth contributions are deemed to come out first, followed by any earnings. Earnings are also tax-free if made after a five-calendar-year holding period, starting with the year the IRA owner first contributed to any Roth IRA. For example, if the IRA owner first contributed to a Roth IRA in 2014 and died in 2016, any earnings distributed from the IRA after 2018 will be tax-free.

Creditor protection

Traditional and Roth IRAs are protected under federal law if you declare bankruptcy. The IRA bankruptcy exemption was originally an inflation-adjusted $1 million, which has since grown to $1,283,025. Unfortunately, the U.S. Supreme Court has ruled that inherited IRAs are not covered by this exemption. (If you inherit an IRA from your spouse and treat that IRA as your own, it's possible that the IRA won't be considered an inherited IRA for bankruptcy purposes, but this was not specifically addressed by the Court.) This means that your inherited IRA won't receive any protection under federal law if you declare bankruptcy. However, the laws of your particular state may still protect those assets, in full or in part, and may provide protection from creditors outside of bankruptcy as well.

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What is the most important component of GDP in the United States?

We often hear in the media that consumer spending is crucial to the overall health of the U.S. economy, but exactly *how* important is it? Representing approximately two-thirds of overall GDP, consumption--the almighty consumer--is the largest driver of economic growth in the United States. Of the nearly $18 trillion in U.S. GDP (2015), American shoppers are responsible for a piece of the pie worth about $12 trillion.

Consumption is tracked by the Bureau of Economic Analysis, and is reported as Personal Consumption Expenditures (PCE) in its monthly "Personal Income and Outlays" news release. Since the late 1960s, PCE as a percentage of overall GDP has crept up from a low of approximately 58% to nearly 70% today.

PCE is divided into goods and services. The services category typically represents the largest part of PCE, accounting for more than 65% over the past two years. Examples of services include health care, utilities, recreation, and financial services.

Goods are broken down further into durable and nondurable goods. Durable goods are those that have an average life of at least three years. Examples include cars, appliances and furniture. Nondurable goods are those with an average life span of less than three years and include such items as clothing, food, and gasoline.

Durable goods represent approximately 10% of total PCE, while nondurable goods make up about 20%.

So the next time you're out shopping, for anything from a bottle of ketchup to a new car, consider that you're doing your part to fuel our nation's growth.

Sources: World Bank.org, accessed June 2016; Federal Reserve Bank of St. Louis, 2016; Bureau of Economic Analysis, 2016

How is GDP calculated in the U.S.?

GDP, or gross domestic product, is a measurement of the total value of all goods and services produced in the United States over a given time period. It is used by economists, government officials, market forecasters and others to gauge the overall health of the U.S. economy.

Although there are several ways of calculating GDP, the *expenditures approach* is the most common. It focuses on final goods and services purchased by four groups: consumers, businesses, governments (federal, state, and local), and foreign users.

The calculation and a description of its components follow:

C+I+G+(X-M)

Consumption (C): Also known as personal consumption, this category measures how much all individual consumers spend in the U.S.

Investment (I): Not to be confused with investments in the stock and bond markets, this is the amount businesses spend on fixed assets (e.g., machines and equipment) and inventories, as well as the amount spent on residential construction.

Government (G): This category tracks the amount the government spends on everything from bridges and highways to military equipment and office supplies. It does not include "transfer payments"--for example, Social Security and other benefit payments.

Exports (X): This is the value of goods and services produced in the U.S. and purchased in foreign countries.

Imports (M): This is the value of goods and services produced in foreign countries and purchased in the U.S.

Historically, the U.S. has run a "trade deficit," which means imports have outpaced exports.

Once the final GDP values are calculated, the percentage change is calculated from one time frame to the next, generally quarter to quarter or annually. Reported quarterly by the Bureau of Economic Analysis, these percentages can influence both investment markets and policy decisions.

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