

Generous Grandparents

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The little ones are sooo cute. You want to spoil them rotten. Learn how to teach your grandchildren about the value of money and to share your wealth judiciously.

The information contained herein is for educational use only and should not be construed as tax, financial, or legal advice. Each individual's situation is unique and may require specialized treatment. It is, therefore, imperative that you consult with tax and legal professionals prior to implementation of any strategies discussed.

I. Lesson Plan

A. Teaching Values [excerpted from **Silver Spoon Kids**]

- Children should know the worth of items, but not relate everything to dollars and cents (→ life is about more than money)
- Know which values you embrace emotionally (care about), intellectually (think about), and behaviorally (act upon): Power, Independence (self-reliance), Curiosity, Acceptance (inclusion), Order (organization), Saving (collection), Honor (loyalty), Social Idealism, Family, Status (social standing), Vengeance, Romance, Tranquility
- Silent treatment robs children of necessary skills. Ask yourself...
Would you feel uncomfortable telling your (grand) children about your income and net worth? How can you be sure that your (grand)child's eventual inheritance is not a disincentive to responsible behavior?
- Worst Things to Say: "We can't afford it." "We'll talk about it later." "Money is the root of all evil." "They're disgustingly rich." "Be thankful you don't live *there*." "Time is money."
- Create teachable moments: Child picks up a coin inquisitively, child asks how much something costs at the store, child wants the same expensive gift his friend received, open a bank or investment account for the child

B. Allowance= gives the child the opportunity to share in the family's net worth

- Could start as early as age 3 or 4 when child can distinguish between nickels and dimes, but no later than 7 or 8
- Pay weekly at first, but then monthly once child is in high school to teach budgeting skills
- National standard seems to be \$1/week for each year of the child's age
- Should not be tied to household chores which should be uncompensated and part of sharing family responsibilities
- Do not tie allowance to grades—avoid externalizing motivation
- Use tripartite method to allocate between spending, saving, and charitable giving
- Require child to make 2 spending lists: essentials (lunch money, school supplies, sports equipment) versus nonessentials (toys, videos, gifts)—reserve veto rights



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- C. Homework [excerpted from TIME Magazine, October 2004]
- Purpose: Instill work ethic, build character, and place work into perspective
 - It has a measurable impact on academic achievement, teaches responsibility and organizational skills, fosters study habits and shows kids that learning takes place outside the classroom
 - Rule of thumb: 10 min. per night per grade level. If the teacher assigns too much, approach the teacher first and then consider seeing the principal.
 - Homework shouldn't be left until just before bedtime. But what if it's 10:30 and your 10-year-old is still toiling away? Send him to bed!
 - Having parents quietly reading nearby can foster an academic atmosphere and make children feel supported in their work.
 - How much should a parent get involved? Stand back. Homework teaches kids how to study independently.

II. Philanthropy

A. Statistics

- Elimination of estate tax expected to cause charitable bequests to drop by 22-37% [Urban-Brookings Tax Policy Center] → We need a new crop of donors



B. Instilling Charity

- Family allocations
- Parental matching (by a factor of 10)
- Organizations of potential interest to children: Make-a-Wish Foundation, Fulfillment Fund, animal shelter, museums, zoo
- Volunteer opportunities: Earth Day clean-up (April 22, 2005), Habitat for Humanity, Meals-on-Wheels during holidays after-school mentoring and tutoring programs
- Toy drives and food banks
- McDonald's gift certificates for the homeless
- Trick-or-treat for UNICEF
- Donate blood

III. College Savings

A. Uniform Transfers To Minors Act (UTMA)

- Custodial accounts established in the name of the child
- Parent or another adult is named as fiduciary
- Account is set up with child's Social Security Number and is taxed to the child
- The assets are irrevocably the child's property and control of the account transfers at the age of majority (18 in CA)

Tax Tip: Appoint someone other than the donor as custodian to avoid the inclusion of the gift in the donor's taxable estate.

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B. Coverdell Education Savings Accounts (ESA)



- Formerly known as Education IRA
- Trust established to pay qualified education expenses of a designated beneficiary for elementary, secondary, and post-secondary education expenses for tuition, fees, supplies, and room and board if living away from home
- Contributions are nondeductible
- Earnings grow tax deferred and distributions are tax free if used for qualified educational expenses
- Total contribution limit to all Coverdell ESAs set up for any one beneficiary (under age 18) is \$2,000/year
- Phase-out: \$95-110K (S) or \$190-220K (MFJ)
- Amounts not withdrawn and used for education expenses must be distributed within 30 days after a beneficiary reaches age 30. The beneficiary is then taxed on the earnings portion of the distribution.
- Rollovers may be made to another Coverdell ESA for the same beneficiary or for other family members under age 30. One rollover per year is allowed which must be completed within 60 days after withdrawal.

C. Qualified Tuition Programs (§ 529)

- Two types of plans are available:
 - 1) Prepaid programs—used to prepay tuition for a designated beneficiary
 - 2) Savings account plans—established to pay for beneficiary's qualified higher education expenses
- Contribution rules:
 - 1) The contributor is not subject to any AGI limitations
 - 2) The contribution is limited to the amount of the beneficiary's qualified expenses
 - 3) The contribution is considered a completed gift and is exempt from estate taxes
 - 4) An election is available that allows contributions larger than the annual gift exclusion to be taken into account ratably over 5 years. Example: An individual can contribute \$55,000 without gift tax consequences as long as no further gifts are made to the same person within five years.
 - 5) Individuals who contribute to a private prepaid plan are not allowed to make contributions to a savings account plan.
- Distribution rules:
 - 1) Distributions from the plan are excluded from income if used for qualified higher education expenses.
 - 2) Distributions not used for qualified expenses are subject to a 10% penalty
- Contributions may be made to a § 529 plan and a Coverdell ESA for the same beneficiary during the same year
- The Hope or Lifetime Learning Credit can be claimed in the same year that a tax-free distribution is received from the § 529 plan, if the distribution is not used for the same expenses for which the credit is claimed.



D. Qualified Transfers

- Direct payment of medical expenses or tuition for another person is not a gift
- Payment must be made to the school or medical provider and not to the beneficiary (who need not be related)

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- Payments for books, supplies, dormitory fees and board do not qualify, but tuition for a part-time student qualifies
- Contributions to qualified tuition programs do not qualify

IV. Investment Alternatives

Saving for College: How Much Will 4 Years Cost?

©2003 by College Entrance Examination Board.

Child's age	School Years	Public (In-State)	Public (Out-of-State)	Private
2	2019-2020	\$130,147	\$196,439	\$277,935
7	2014-2015	\$101,974	\$153,915	\$217,770
12	2009-2010	\$79,899	\$120,597	\$170,628
17	2004-2005	\$62,603	\$94,491	\$133,692

Savings Requirement to Meet Costs:

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		<u>Example</u>
1. Future Cost of College [see above]	_____	\$101,974
2. Number of Years until College [18 minus child's age]	_____	11
3. Return-Rate Factor	_____	

Years to College	Return-Rate Factor (based on assumed rate of 8%)
1	1.00
6	7.34
11	16.65
16	30.32

4. Annual Savings Target [Divide Line 1 by Line 3]	_____	16.65
5. Monthly Savings Target [Divide Line 4 by 12]	_____	\$6,125
	_____	\$510

A. Series EE and I Bonds

- Interest earned on EE and I bonds issued after 1989 is tax free if the bonds are used for college tuition and does not exceed actual educational expenses in year of redemption. MFS filers are not eligible for exclusion
- Bond owner must be at least 24 years old before bond's issue date
- Bond proceeds must be used for tuition and fees for dependent, spouse or bond owner at a qualifying educational institution. Room, board and books do not qualify
- Phase-out: \$9,850-74,850 (S) or \$89,750-119,750 (MFJ) The AGI phase-out applies to the year of redemption

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	EE Bond	I Bond
Features	Issued at 50% of face value. (A \$100 EE Bond costs \$50.)	Issued at face value. (A \$100 I Bond costs \$100.)
	Offered in 8 denominations (\$50, \$75, \$100, \$200, \$500, \$1,000, \$5,000, and \$10,000).	Denominations: Same as EE.
	\$30,000 issue price annual purchase limit per person.	\$30,000 annual purchase limit per Social Security Number.
Interest	Calculated as 90% of 6-month averages of 5-year Treasury Securities yields. 2.84% through October 2004.	Calculated as an earning of a fixed rate of return and a semiannual inflation rate based on CPI-U. 3.39% through October 2004.
	Rates announced every May 1 and November 1.	Rate Announcement: Same as EE.
	Guaranteed to reach face value in 20 years.	No guaranteed level of earnings.
	Increases in value monthly and compound semiannually. Interest is paid when the bond is redeemed.	Generally increases in value monthly and interest compounds semiannually (except in periods of deflation when the bond value could remain unchanged). Interest is paid when the bond is redeemed.
	Earn interest for up to 30 years.	Life span: Same as EE.

B. Mutual Funds

Advantages offered: Ease of purchase, fractional shares, dollar-cost averaging, professional management, diversified portfolio, liquidity

C. Life Insurance

Reasons to purchase:

- **INSURABILITY**--Purchasing life insurance on a healthy child protects against future injury or illness that could affect the ability to secure life insurance later.
- **SAVINGS**--A universal life insurance policy can build cash value that can be used to offset future premiums or possibly be borrowed against for education expenses.
- **INSURANCE INTO ADULTHOOD**--Purchasing a policy while premiums are low and can be maintained into adult years.
- **LOAN REPAYMENT**—Protection ensuring that student loans can be repaid in the event of an untimely death.

D. Home Purchase

1. Gift the down-payment, making sure not to exceed the annual gift tax exclusion (\$11K/person)
2. Lend the down-payment—parent need not charge interest on loans under \$10K (de minimus exception) OR on loans under \$100K if the child's net investment income is less than \$1K
3. Lend money to help buy-down the mortgage interest rate, which will gradually rise along with the child's income
4. Buy the home and rent it back to child with an option to buy. The rent charged must be fair market rent.
5. Enter into an equity-sharing arrangement whereby parent and



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child each contribute part of the down-payment and take title as co-owners. Each pays a proportionate share of the mortgage installments and upkeep, the child pays fair rent to the parent for the parent's share of the house, and the parent deducts his or her share of rental expenses. If the home goes up in value, the profit is shared.

V. Tax Issues

- A. Kiddie Tax—child's investment income is taxed at parents' rate
- Applies to children under age 14
 - Applies to investment income in excess of \$1,500
 - Choice of filing methods include Form 8615 attached to child's 1040 (Option A) OR Form 8814 attached to parents' 1040 (Option B)
 - Advantages to Option B: No separate return required for child BUT various phase-outs may apply to parents' income due to additional includible amounts
- B. Dependency Exemptions—\$3,100 in 2004
- Support Test—taxpayer must provide more than 50% of dependent's total support AND
 - Gross Income Test—dependent must have less than \$3,100 of gross income unless dependent is a child under age 19 OR is a full-time student during at least 5 months of the year and under age 24 AND
 - Citizenship Test—dependent must be a U.S. citizen AND
 - Joint Return Test—dependent may not file a joint return AND
 - Member of Household or Relationship Test—dependent must: live in the taxpayer's household for the entire year OR be related
- 
- C. Education Incentives [see IRS Publication 970 Tax Benefits for Education]
1. Student Loan Interest Deduction
 - Maximum deduction of \$2,500 on qualifying loans for tuition fees, room and board, books, and equipment paid to an eligible institution
 - Phase-out: \$50-65K (S) or \$100-130K (MFJ)
 2. Tuition and Fees Deduction
 - Maximum deduction of \$4,000 on qualified higher education expenses paid to an accredited institution
 - Phase-out: \$65-80K (S) or \$130-160K (MFJ)
 - Disallowed if claiming Hope Scholarship or Lifetime Learning Credits
 3. Hope Scholarship Credit
 - Maximum credit of \$1,500 on tuition and fees paid for the first 2 years of post-secondary education in a degree program
 - Student must be enrolled in at least ½ of the normal academic load
 - Credit cannot be claimed if Lifetime Learning Credit is claimed
 - Not available if filing MFS
 - Phase-out: \$41-51K (S) or \$83-103 (MFJ)

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4. Lifetime Learning Credit
- Maximum credit is 20% of qualified tuition and fees; maximum \$2,000
 - Non-degree candidates are eligible
 - Credit cannot be claimed if Hope Scholarship Credit is claimed
 - Not available if filing MFS
 - Phase-out: \$41-51K (S) or \$83-103 (MFJ)

Tax Tip: The parent who does not qualify for the education credit due to AGI limitations should not claim the dependency exemption and should instead allow the student to claim the education credit on his own return.

Education Tax Incentives Comparison Chart for 2003									
	Hope Credit <i>See Page 12-8</i>	Lifetime Learning Credit <i>See Page 12-8</i>	Coverdell ESA (1) <i>See Page 13-4</i>	Withdrawal From Traditional and Roth IRAs (1) <i>See Tab 14</i>	Student Loan Interest <i>See Page 13-6</i>	Qualified Tuition Programs <i>See Page 13-6</i>	U.S. Government Savings Bond Exclusion (1) <i>See Page 13-7</i>	Educational Assistance Program (1) <i>See Tab K (2)</i>	Tuition and Fees Deduction <i>See Page 13-7</i>
Tax Benefit (3)	Nonrefundable tax credit	Nonrefundable tax credit	Withdrawals are tax free	No 10% early withdrawal penalty	AGI deduction	Prepay future tuition or tax-free withdrawals	Interest is excludable from income	Employer benefits are excludable from income	AGI deduction
2003 Annual Limits	Credit up to \$1,500 per student; 100% of first \$1,000 and 50% of next \$1,000	Credit up to \$2,000 per family; 20% of up to \$10,000 of expenses	\$2,000 contribution per child under age 18 and any age special-needs child	Amount of qualifying expenses	Interest paid deduction of up to \$2,500	Amount considered necessary to cover qualified expenses	Amount of qualifying expenses	Exclude up to \$5,250 of benefits	Deduction of up to \$3,000
Qualifying Expenses Besides Tuition and Required Enrollment Fees (3)	None	None	Books, supplies and equipment; room and board if at least half-time attendance; payments to QTP	Books, supplies and equipment; room and board if at least half-time attendance	Books, supplies and equipment; room and board, transportation, other necessary expenses	Books, supplies and equipment; room and board if at least half-time attendance	Payment to QTP, payment to Coverdell ESAs	Books, supplies and equipment	None
Qualifying Education	First two years of undergraduate	All undergraduate and graduate levels	Elementary, secondary, undergraduate and graduate levels	All undergraduate and graduate levels	All undergraduate and graduate levels	All undergraduate and graduate levels	All undergraduate and graduate levels	All undergraduate and graduate levels	All undergraduate and graduate levels
Other Requirements	Can be claimed only for two years; must be enrolled at least half-time in a degree program	Available for unlimited number of years for both degree and non-degree programs	Contributions are not deductible and must be made by the return due date; may also contribute to QTP	See Tab 14 for requirements	Must be enrolled at least half-time in a degree program		Applies only to qualified Series EE bonds issued after 1989 or Series I bonds	Cannot also claim as education credit	Not allowed if expense is allowable under another provision
2003 AGI Phase-Out				N/A		N/A		N/A	Not allowed if AGI exceeds: MFJ \$130,000 All Others \$ 65,000 MFS \$ 0
	MFJ \$83,000 – 103,000 All Others ... \$41,000 – 51,000 MFS \$0	\$83,000 – 103,000 \$41,000 – 51,000 \$0	\$190,000 – 220,000 \$ 95,000 – 110,000 \$ 95,000 – 110,000		\$100,000 – 130,000 \$ 50,000 – 65,000 \$0		\$87,750 – 117,750 \$58,500 – 73,500 \$0		

(1) Any nontaxable withdrawal is limited to the amount of qualifying educational expenses.
(2) In the *Small Business Quickfinder® Handbook*.
(3) Qualifying educational expenses must be reduced by any tax-free income. The same educational expenses cannot be used for figuring more than one benefit.

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D. Generation-skipping Tax (GST)

- Taxpayer transfers to a grandchild are subject to the GST tax (48% in 2004) in addition to estate and gift taxes on the transfer. The combined tax paid on a generation-skipping transfer is generally higher than the estate tax that would have been paid if the property had been transferred down through each successive generation.
- GST tax is imposed on direct skips, trust terminations, and distributions
- A skip person is a relative two or more generations below the transferor. If the transferor's child is deceased, the grandchildren by that child are not considered skip persons.
- Each transferor has a \$1.5 million exemption
- GST tax is repealed for transfers made after December 31, 2009



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VI. References and Resources

A. Books

- **Silver Spoon Kids: How Successful Parents Raise Responsible Children** by Eileen and Jon Gallo
- **Raising Financially Fit Kids** by Joline Godfrey
- **Mommy Are We Rich? Talking to Children About Family Money** by Barbara Hauser
- **The Procrastinating Child** by Rita Emmett



B. Websites

1. College Planning
 - www.smartmoney.com/college
 - <http://www.finaid.org/>
2. For Kids to Use [ration computer time and install protective software]
 - <http://www.fool.com/teens/teens.htm>
 - <http://www.jumpstart.org/>
 - <http://senseanddollars.thinkport.org/>
 - <http://www.practicalmoneyskills.com/english/students/>
 - <http://www.ncee.net/>
 - <http://www.kidsbank.com/>
 - http://www.consumerjungle.org/s_default.htm
 - <http://www.treas.gov/kids/>
 - <http://www.escapefromknab.com/>



VII. Gifts

A. Books

- **The Ig Nobel Prizes**, Marc Abrahams: Here are the anti-Nobels—prizes that should have been awarded for such accomplishments as treating snakebites with electroshock and calculating how many times toast will fall buttered side down.
- **The Magic of Mathematics**, Theoni Pappas
- **Earth from above for Young Readers**: 170 color photographs, shot from a helicopter, of the farthest reaches of the Earth, including the author's thoughts on the planet, its future, and who we are as a global population.

B. Magazine Subscriptions

- TIME for Kids (800) 777-8600
- National Geographic Kids (800) 647 5463
- Sports Illustrated for Kids (800) 833-1661



C. Extracurricular Activities

- Chef Eric's Culinary Classroom—each day will be fun filled with kitchen activity! Your children will return home with new stories, skills and friends. 2366 Pelham Avenue Los Angeles (310) 470-2640

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- Shuttle Camp is held at the New Mexico Museum of Space History in Alamogordo, NM. Students will test out high-adventure fun, teamed with hands-on exposure to living and working in space. (877) 333-6589
- U.S. Space and Rocket Center in Huntsville, AL (800) 63-SPACE.

VIII. Fun Things to Do Together

A. Places to Go

1. Getty

- Hours: T-Th, Sun 10-6; F & Sat 10-9; closed Mon
- *Family Fun at the Getty* brochure
- Use Art Detective Cards to find the art and solve the mystery while exploring the galleries, garden, and architecture
- Music, sound effects, and fun, brain-teasing questions abound on the Museum's Family Audioguide
- One-hour tours for children (ages 5 and up) and adults feature a fun, activity-filled visit to the galleries beginning at 1:30 p.m.

2. Skirball Museum

- T-Sat 12-5; Th 12-9; Sun 11-5; closed Mon
- *Einstein*: Examine Einstein's report card, inspect his FBI file, and enjoy his family photographs, love letters, and diary entries. Exhibition highlights include scientific manuscripts and original correspondence—including original handwritten pages from the 1912 manuscripts of the special theory of relativity and his 1939 letter to President Roosevelt about nuclear power—and a wealth of other documents from the Albert Einstein Archives at the Hebrew University of Jerusalem, as well as interactive exhibits



3. The Bunny Museum

- Every day; by appointment
- 1933 Jefferson Drive Pasadena (626) 798-8848

4. Magicopolis

- F & Sat 8 PM; Sat & Sun 2 PM
- 418 Fourth Street Santa Monica (310) 451-2241
- Mixing sketch comedy and magic acts, the husband and wife team of Steve Spill and Bozena serve up a vaudeville style show, complete with one liners, show girls and acts of prestidigitation that leave audience members pondering, "How did they do that?"



B. Tours

1. Guide Dogs of America

- Tuesday, Wednesday and Thursday at 10 a.m. and 2 p.m. (minimum age 9 years or 4th grade)
- 13445 Glenoaks Boulevard, Sylmar (818) 362-5834



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2. Los Angeles Times
 - Tours M-F at 9:30, 11:00, 1:30
 - (213) 237-5757



C. Exciting Meals

1. El Mercadito
 - Mariachi bands
 - 3425 East First Street East Los Angeles (Boyle Heights)
2. Bhan Kanan Thai
 - crepe desserts made fresh 11 AM & 9 PM
 - 5271 Hollywood Blvd, Los Angeles, CA 90027, (323) 871-8030
3. Dippin' Dots
 - Dodger Stadium, Universal Citywalk, Greek Theater, LA Zoo, Rosebowl
 - Dippin' Dots® is the world's coldest ice cream and certainly the most unique frozen dessert, flash-frozen using a special patented process.

D. Out of Town

1. Calico Ghost Town
 - Daily 8-Dusk
 - P.O. Box 638 Yermo (800) TO-CALICO
 - Reconstructed to recreate the spirit of Calico's Old West past. 90 minute Ghost Tours after dark every Friday and Saturday night. Narrow gauge railroad and hard rock underground silver mine.
2. Quicksilver Ranch Miniature Horses
 - Daily 10-3
 - 1555 Alamo Pintado Road Solvang (805) 686-4002



E. Games

1. Monopoly
2. Internet Games
 - <http://www.ja.org/studentcenter/persfin/money-might.shtml#>
 - <http://www.siainvestor.com/siagame.htm>
 - <http://www.smgww.org/>
 - <http://www.hsx.com/>
3. Investment Clubs
 - www.better-investing.com



- F. Movies about Stock Market: *Barbarians at the Gate*, *Boiler Room*, *Bonfire of the Vanities*, *Ghost*, *Other People's Money*, *Trading Places*, *Wall Street* AND... *Fantasia!*

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