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Resolute Connections

April 15th has come and gone, and some wonder, where does all that money go? *Where the Money Goes* provides an overview of what our tax dollars buy, what is surprising is that many of the line items that grab the public's attention are relatively minor. *Creative Giving* discusses one way to cut your tax bill while helping out a cause of your choice. And the never ending saga of Britain leaving the European Union is touched upon in *Brexit is Beginning*.

If you have any questions about anything we have covered in the articles below, or a specific situation please feel free to give us a call, or visit our website, www.ResoluteFinancial.com.

Where the Money Goes

It's tax time again, and as you look over your tax payments for calendar 2016, you're undoubtedly wondering where those dollars are being spent.

The Wall Street Journal recently published a chart which breaks down spending for every $100 of tax receipts—and concludes that the U.S. government is actually a very large insurance company that also happens to have an army.

For every $100 you pay in taxes, $23.61 goes to Social Security payments and administration—basically old age insurance for retirees. Another $15.26 goes to Medicare, the government health insurance program. Medicaid, the health insurance program for the poor, accounts for another $9.55 of that $100 tax bill—bringing the total costs for various civilian insurance programs to 48% of the total budget. And that army? It costs $15.24 of every $100 the government collects in taxes, not counting veterans benefits.

In all, the 2016 federal budget fell $15.24 out of every $100 short of revenues equaling expenses. Where would you cut?

Things like federal expenditures and grants for education ($2.08), food stamps ($1.89), affordable housing ($1.27) and foreign aid ($1.14) actually make up a very small part of the budget, smaller than interest payments on the national debt ($6.25).

There has been talk about helping reduce the budget by lowering expenditures on the National Endowments for the Arts and Humanities, which together represent eight tenths of one cent of that $100 tax bill. This would be comparable to someone trying to pay off his mortgage by looking for coins under the sofa cushions.

Creative Giving

Giving to a charity is easy, right? You write a check and send it off to your favorite 501(c)(3) organization, and get a full deduction for the amount on your tax return, up to 50% of your adjusted gross income.

Most professionals would recommend that you put a bit more thought into how you give. For instance, instead of giving cash (which is basically what you're doing when you write that check) you could try a more tax-friendly approach: give stock or mutual funds that have gone up in value during your time of ownership. You get a deduction equal to the full value of the securities at the time of donation (rather than how much you originally paid for them), and never have to pay capital gains taxes on the appreciation.

If you want your donation to provide income during your retirement, consider a charitable remainder annuity trust or charitable remainder unitrust, where you put money in a trust set aside for your favorite charity. Over the rest of your life (actually up to a maximum of 20 years) you receive income of at least 5% of the original trust value (annuity trust) or the annually-recalculated actual value (unitrust) each year. When you die, or the term of the trust runs out, whatever assets remain in the trust are forwarded on to the designated charity. In each case, there is a tax calculation, based on the assets and the income you receive, which determines how much of a deduction you will get when you make the donation to the trust. And you avoid paying capital gains and depreciation tax recapture (if the assets happen to be real estate) on the property you contribute.

As an example, suppose you happened to have $1 million worth of real estate that you originally purchased for $200,000. When you sold these properties, you would owe capital gains taxes on the $800,000 of appreciation, plus recapture of the annual depreciation deductions.

Now let's suppose you donated this property to a charitable remainder unitrust. The unitrust would sell the properties for $1 million and reinvest that money in stocks or mutual funds. Under this arrangement, you might get income in the first year of $60,000 (6% of the trust amount), avoid $120,000 in capital gains taxes, and receive an immediate tax deduction of somewhere in the neighborhood of $400,000.

If the stocks and funds in the trust were to earn 7% a year (no guarantee, obviously), then the value of the trust would increase, over the next 20 years, to just under $1.5 million, at which time the full amount would be donated to the charity. Overall, you might receive roughly $1.2 million in income over that same 20-year time period—a figure which, again, depends on the earnings inside the trust.

Another alternative is the lead trust, which works essentially the same way, except that this time the income is paid to the charity for that 20 year term, and then the assets in the trust pass to your heirs estate-tax-free. The lead trust is only appropriate if your assets at death would exceed the current estate tax threshold ($5.49 million per individual, $10.98 million for couples). Of course, the current Presidential administration has vowed to eliminate estate taxes altogether, so not many are rushing to implement lead trusts at the present time.

Finally, some families are creating a charitable inheritance, where the parents donate to a donor-advised fund, receive their tax deduction, and the donor-advised fund invests the assets to grow until the fund is told where they should be distributed. The children are designated as the advisor to those assets, giving them the right to instruct the donor-advised fund where to make donations. It's a simple, creative way to provide the adult children with an opportunity to determine their own charitable inclinations.

The bottom line here is that giving can be more rewarding, and more interesting, than simply writing a check.

Brexit Is Beginning

If you have a good long memory, you may recall that last Summer, the U.K. panicked the investment markets by voting, in a nation-wide referendum, to exit the European Union. There were, of course, dire predictions about the impact on the U.K. economy, which never materialized, in large part because the U.K. had not yet formally opted out of its Eurozone agreements.

At the end of March, the U.K. finally pulled the trigger, and made the departure from the European Union official. The Queen of England delivered her royal assent, and the U.K.'s envoy to the European Union handed-delivered a letter to the office of the European Council president in Brussels invoking Article 50 of the EU treaty. This delivered formal notification of the Brexit decision, the first time this has happened in the EU's history.

So that means those dire predictions will finally come true. Right?

As it happens, Article 50 was intended to prevent any rash or immediate consequences of an exit from EU membership, and it seems to have accomplished that goal. Under the bylaws, the divorce will be negotiated, item by item, over the next two years, meaning that any change in economic circumstances will be gradual and perhaps accommodated as they happen. How gradual? Over the next several weeks, the EU's remaining 27 members will discuss their priorities in advance of the negotiations, and then hold a summit on April 29. Only then will the European Commission have a mandate to negotiate with representatives from London.

What will the negotiations cover? First up will be Britain's obligations to the EU for its participation thus far—a bill that could total up to roughly $65 billion. Also: what will be the rights of 3 million EU citizens living in the U.K., and the rights of more than 1 million Britons living and working in the Eurozone?

After that, it is speculated that the British government will seek to negotiate a broad free-trade agreement which will effectively replicate the provisions of its former membership in the European Union, as a way to protect its commercial ties with the Continent. This is where negotiations will get sticky, since France and Germany will almost certainly oppose a no-consequences exit, and they will want to protect their own economies' free-trade access to Eurozone markets. On the EU side, a simple majority of countries will decide what proposals are accepted and which are sent back to the negotiating table—with one notable exception: any free trade agreement between the two sides much win unanimous approval.

This latter issue is problematic for the U.K., because it exposes each country to yet another referendum on the conditions of EU membership; the citizens of France, Germany, Luxembourg, Ireland, Holland and, well, all the other nations would want to be involved in the final decision, which would give them yet another opportunity to voice displeasure with the EU and stir up nationalistic parties and sentiments.

Also still to be determined are budgetary considerations. The U.K.'s contribution to the governing infrastructure of the EU will have to be made up by the remaining members, whose citizens are not eager to contribute more to the increasingly unpopular entity. The British government, meanwhile, will have to create an expensive governance infrastructure to replace the EU bureaucracy in Brussels, and Parliament will have to formally repeal the European Communities Act of 1972, making EU law U.K. law. Then, parallel with the EU negotiations, Parliament will debate every aspect of the EU law and decide which to keep long-term and which to drop. That, too, will take years.

The bottom line is that nothing dramatic is likely to happen, economically and in the investment markets, for years. Throughout the two years of negotiations, the U.K. will remain a full EU member, albeit without a chance to participate in EU decision-making. Some are predicting that the discussions will last for several additional years, with extensions on the status quo until issues can be ironed out. Unpicking 43 years of treaties and agreements covering thousands of different subjects will not be an easy task.

Those investors who overreacted to the initial (and shocking) Brexit vote sold their stocks into a market rally, and there is no reason to think that those who might panic now that the trigger is finally pulled will fare any differently. Both sides in this negotiation have a stake in not having anything dramatic—particularly dramatically damaging—from happening, and they will probably succeed in making Brexit a boring exercise in bureaucratic handover.

Source:

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For more information on these topics or for a free consultation, contact Resolute Financial, LLC at (978) 463-8771 ext. 1003.