ITI Financial Mgt. Enewsletter

Planning Your Financial Future

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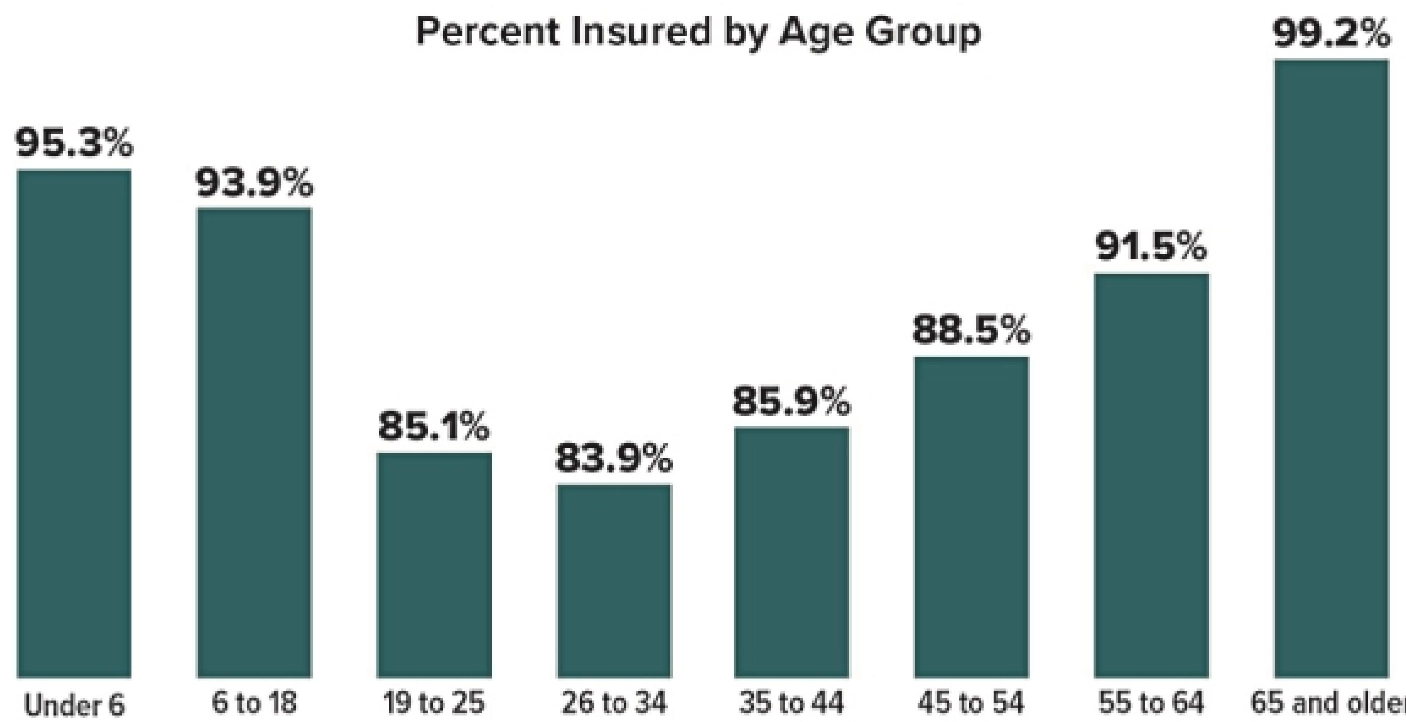
Young Adults Are More Likely to Lack Health Coverage

Children are often covered by a parent's health plan or by public health insurance such as the Children's Health Insurance Program (CHIP). But young adults generally lose eligibility for CHIP at age 19 and for coverage under a parent's health plan at age 26. Before they transition into employer-sponsored health plans or buy private health insurance, young adults are more likely to be uninsured than other age groups.



Source: American Community Survey, U.S. Census Bureau, 2020

Considerations When Making Gifts to Children

If you make significant gifts to your children or someone else's children (perhaps a grandchild, a nephew, or a niece), or if someone else makes gifts to your children, there are a number of things to consider.

Nontaxable Gift Transfers

There are a variety of ways to make transfers to children that are not treated as taxable gifts. Filing a gift tax return is generally required only if you make gifts (other than qualified transfers) totaling more than $15,000 per individual during the year.

- **Providing support.** When you provide support to a child, it should not be treated as a taxable gift if you have an obligation to provide support under state law. Parents of minor children, college-age children, boomerang children, and special-needs children may find this provision very useful.
- **Annual exclusion gifts.** You can generally make tax-free gifts of up to $15,000 per child each year. If you combine gifts with your spouse, the amount is effectively increased to $30,000.
- **Qualified transfers for medical expenses.** You can make unlimited tax-free gifts for medical care, provided the gift is made directly to the medical care provider.
- **Qualified transfers for educational expenses.** You can make unlimited gifts for tuition free of gift tax, provided the gift is made directly to the educational provider.

For purposes of the generation-skipping transfer (GST) tax, the same exceptions for nontaxable gift transfers generally apply. The GST tax is a separate tax that generally applies when you transfer property to someone who is two or more generations younger than you, such as a grandchild.

Income Tax Issues

A gift is not taxable income to the person receiving the gift. However, when you make a gift to a child, there may be several income tax issues regarding income produced by the property or from sale of the property.

- **Income for support.** Income from property owned by your children will be taxed to you if used to fulfill your obligation to provide support.
- **Kiddie tax.** Children subject to the kiddie tax are generally taxed at their parents' tax rates on any unearned income over $2,200 (in 2021). The kiddie tax rules apply to: (1) those under age 18, (2) those age 18 whose earned income doesn't exceed one-half of their support, and (3) those ages 19 to 23 who are full-time students and whose earned income doesn't exceed one-half of their support.
- **Basis.** When a donor makes a gift, the person receiving the gift generally takes an income tax basis equal to the donor's basis in the gift. The income tax basis is generally used to determine the amount of taxable gain if the child then sells the property. If instead the property were transferred to the child at your death, the child would receive a basis stepped up (or down) to the fair market value of the property.

Gifts to Minors

Outright gifts should generally be avoided for any significant gifts to minors. For this purpose, you might consider a custodial gift or a trust for a minor.

- **Custodial gifts.** Gifts can be made to a custodial account for the minor under your state's version of the Uniform Gifts/Transfers to Minors Acts. The custodian (an adult or a trust company) holds the property for the benefit of the minor until an age (often 21) specified by state statute.
- **Trust for minor.** A Section 2503(c) trust is specifically designed to obtain the annual gift tax exclusion for gifts to a minor. Principal and income can (but need not) be distributed to the minor before age 21. The minor does generally gain access to undistributed income and principal at age 21. *(The use of trusts involves a complex web of tax rules and regulations, and usually involves upfront costs and ongoing administrative fees. You should consider the counsel of an experienced estate professional before implementing a trust strategy.)*

Transfer by Gift Versus Transfer at Death

Difference in taxable gain when appreciated property is sold at fair market value (FMV) after the transfer.

Calculation Steps	Transfer by Gift	Transfer at Death
Sales price (FMV)	$100,000	$100,000
– Income tax basis	– $20,000 (carryover of donor's basis)	– $100,000 (stepped-up to FMV)
Taxable gain	= $80,000	= $0

Corporate Debt: Are Juicier Yields Worth the Extra Risk?

In response to a pandemic-induced sell-off in March 2020, the Federal Reserve announced that it would purchase corporate bonds, including riskier junk bonds, as part of its effort to stabilize the financial markets. Fed bond buying, along with a pledge to keep interest rates near zero for as long as needed, helped to calm the nerves of investors and to keep money flowing into corporate debt. In fact, U.S. corporations issued more than $2.2 trillion in new debt in 2020, up from $1.4 trillion in 2019.[1]

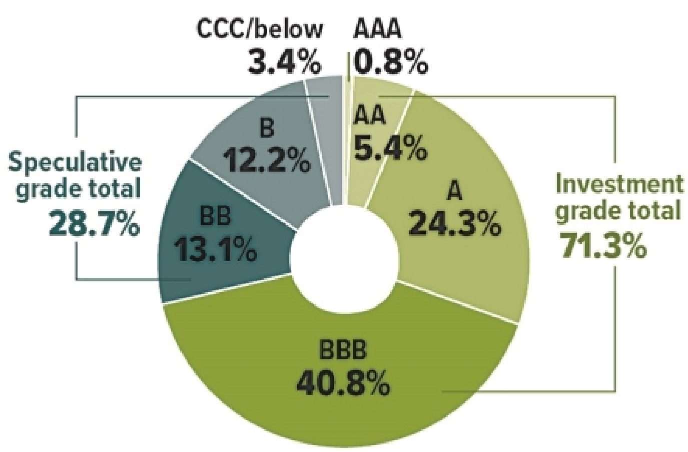
Corporations sell bonds to finance operating cash flow and capital investment. Corporate bonds usually offer higher interest rates — and are subject to more risk — than U.S. Treasury securities with comparable maturities. U.S. Treasury securities are guaranteed by the federal government as to the timely payment of principal and interest, but distressed corporations occasionally default on payments.

Investors who rely on corporate bonds for retirement income, or to help temper the effects of stock market volatility, should consider the degree of risk they are willing to accept in their bond portfolios.

Credit Risk and Ratings

Most corporate bonds are evaluated for credit quality by one or more ratings agencies, each of which assigns a rating based on its assessment of the issuer's ability to pay the interest and principal as scheduled. Bonds rated BBB or higher by Standard & Poor's and Fitch Ratings, and Baa or higher by Moody's Investors Service, are considered investment grade. Lower-rated corporate bonds (called high-yield or "junk" bonds) are considered non-investment grade or speculative, because they are issued by companies considered to pose a greater risk of default. Bond investors generally receive higher yields as compensation for bearing higher risk.

U.S. corporate debt, by rating category (share of total)



Source: S&P Global Ratings, November 2020

Many factors can alter a company's perceived credit risk, including shifts in economic or market conditions, adjustments to taxes or regulations, and changes in management or projected earnings. When a ratings agency upgrades or downgrades a company's credit rating, or even adjusts the outlook, it often causes the prices of outstanding bonds to fluctuate.

An Uneven Outlook

Thanks to the Fed, many companies have been able to borrow at very low rates and with favorable terms, putting them in better shape to ride out the pandemic and repay their debt over time. On the other hand, some companies in sectors that were harshly impacted by social distancing measures and lockdowns — or that were in a weak financial position before the health crisis began — are more vulnerable to credit pressures.

According to a forecast by S&P Global Fixed Income Research, the trailing 12-month default rate for U.S. speculative-grade corporate debt will rise to 9% by September 2021, up from 6.3% in September 2020. However, the risk of default is greater in hard-hit corporate sectors such as retail, restaurants, travel-related sectors, and oil and gas.[2]

Downgraded bonds that lose their investment-grade ratings are known as fallen angels. There was a spike in fallen angel debt in 2020, and the number of potential fallen angels (rated BBB- with a negative outlook) is projected to decline in 2021 but remain elevated.[3]

Thirsting for Yield

After accounting for inflation, the real yields on many U.S. Treasuries have dropped below zero, while the real yields for many investment-grade corporates are barely positive. As a result, some fixed-income investors may be motivated to invest in riskier high-yield corporate bonds.[4]

Investors who stretch for yield should have the discipline to tolerate the price swings typically associated with lower-quality bonds. And considering the potential for lingering economic uncertainty, investors might want to take a selective approach when evaluating corporate bond investments.

The principal value of bonds may fluctuate with changes in interest rates and market conditions. Bonds redeemed prior to maturity may be worth more or less than their original cost.

1) Securities Industry and Financial Markets Association, 2021

2-3) S&P Global Ratings, December 2020

4) *The Wall Street Journal,* November 17, 2020

A Steady Strategy

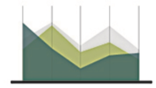
One of the most fundamental truths of investing is that you can't time the market. As legendary investor and economist Bernard Baruch put it, "Don't try to buy at the bottom and sell at the top. It can't be done except by liars."[1]

Even so, it's natural to wince a little when you buy an investment only to see the price drop, or sell only to see the price rise. And no matter how much you try to make objective decisions, you may be tempted to guess at market movements. One approach that might help alleviate some of your concerns is *dollar-cost averaging.*

Regular Investments

Dollar-cost averaging involves investing a fixed amount on a regular basis, regardless of share prices and market conditions. Theoretically, when the share price falls, you would purchase more shares for the same fixed investment. This may provide a greater opportunity to benefit when share prices rise and could result in a lower average cost per share over time.

If you are investing in a workplace retirement plan through regular payroll deductions, you are already practicing dollar-cost averaging. If you want to follow this strategy outside of the workplace, you may be able to set up automatic contributions to an IRA or another investment account. Or you could make manual investments on a regular basis, perhaps choosing a specific day of the month.



No matter how much you try to make objective decisions, you may be tempted to guess at market movements.

You might also use a similar approach when shifting funds between investments. For example, let's say you want to shift a certain percentage of your stock investments to more conservative fixed-income investments as you approach retirement. You could execute this in a series of regular transactions over a period of months or years, regardless of market movements.

Dollar-cost averaging does not ensure a profit or prevent a loss, and it involves continuous investments in securities regardless of fluctuating prices. You should consider your financial ability to continue making purchases during periods of low and high price levels. However, this can be an effective way to accumulate shares to help meet long-term goals.

Asset allocation is a method used to help manage investment risk; it does not guarantee a profit or protect against investment loss. All investments are subject to market fluctuation, risk, and loss of principal. When sold, they may be worth more or less than their original cost.

1) BrainyQuote, 2021

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