FINANCIAL PLANNING FOR THE GROWING FAMILY

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New parents have to make a number of adjustments to their lives. From dealing with diaper rash to sleep deprivation, they have a lot to deal with. But parenting duties are not limited to physical care of a child. There are numerous financial parenting tips that every new parent must consider. This article is intended to hit the high points on the list of financial and estate planning tasks that every new parent should consider.

1) Adjust Income Tax Withholdings. The easiest and quickest way to get extra cash into a new parent's hands is to adjust their income tax withholdings as soon as possible. A new child should allow a new dependency withholding exemption, assuming the child qualifies as a dependent of the parent. A taxpayer qualifies for a dependency exemption in the year of the dependant's birth and for so long as the dependent continues to satisfy the definition of a "dependant" under Internal Revenue Code ("IRC") § 152. The additional dependency exemption should work to reduce a parent's required tax withholdings from his or her paycheck.

The parent should adjust his or her withholding certificate as soon as possible to take advantage of the new withholding exemption. The IRC allows for almost immediate adjustment to an employee's withholding certificate. The IRC even allows prospective adjustments to withholding calculations if furnished before December 1 of the prior year under IRC § 3402(f)(2)(C). The sooner a parent's withholding certificate is adjusted, the sooner his or her take home pay gets a much needed bump.

2) Identify Applicable Tax Breaks. The IRS grants taxpayers several child related tax breaks, in addition to the dependency exemption under IRC § 151. Every parent should examine these tax benefits in calculating their income tax liability.

First, parents are granted a child tax credit of $1,000 under IRC § 24. The child must be a qualifying child under IRC § 152(c), but this definition should cover almost all children living with the parent and less than nineteen years old. The credit is allowable against the alternative minimum tax, but begins to phase out for joint return filers making more than $110,000. For single parents, the phase out starts at $75,000. The phase out is complete at $130,000 for joint filers and $95,000 for individuals. In limited cases, the credit can be refundable under IRC § 24(d).

Parents with less than $15,000 in adjusted gross income are entitled to a tax credit for amounts paid to care for children, if such expenses allow the parent(s) to continue gainful employment. This credit is equal to thirty-five percent of the expenses incurred in caring for a child, up to a maximum amount of $3,000 for one child or $6,000 for two or more children.

Adoptive parents of special needs children also have a special tax break designed solely for them. Under IRC § 23, adoptive parents of children who are less than eighteen years old and physically or mentally incapable of caring for themselves are entitled to a tax credit for adoption expenses of up to $10,000. This credit is subject to a phase out for high earners.

2) Review or Create an Estate Plan. Most new parents don't have an estate plan because they've never thought they needed one. In a sense they are right. Louisiana law generally provides a spouse substantial rights in the community property of a decedent during the surviving spouse's lifetime if the couple has no children. For single people, property usually stays within their family at death. But, when children arrive, a will is a must.

People usually want to leave all of their property to their spouse before any property passes to children, but what happens if both parents die unexpectedly? In this case, someone will need to care for the family property until the children can use it responsibly. Parents typically want their property, no matter the amount, to be used for their children's benefit after the surviving spouse dies, but not necessarily in the child's hands until they are mature enough to use it wisely. Rare is the parent who has no qualms about handing over large amounts of cash (or any other assets) to a teenager. Thus, most parents should consider a contingent trust in their will as a good solution to their newfound estate planning concerns.

A contingent trust only comes into being if both parents die before the children reach an age or ages that the parents choose. The trustee of the contingent trust administers the trust's assets for the benefit of the children and is usually authorized to pay out portions of the trust principal for a child's health, education, and welfare. This arrangement allows a child the benefit of their inheritance, but installs a trustee to stand between the child and the inheritance. The trustee acts a fiduciary over the property and sees that the money is spent prudently. This allows a child the benefit of an inheritance, without granting unfettered access.

Although a will's primary function is the disposition of a person's assets at death, it performs other functions, too. A will names the executor of the person's estate. The executor is the person appointed by the probate court who is in charge of seeing that the desires stated in the will are carried through.

A will may also control perhaps the most important decision a parent is likely to make about their child's day-to-day life after the parent's death, namely who will physically care for the child if the parent passes away. For new parents, the care of a child in case of death is likely to be known informally, but such a crucial decision cries out for a concrete, legal designation.

3) Assess Insurance Needs. Almost all parents will need some form of life insurance. If either parent were to die, the surviving spouse may be left with drastically increased expenses, especially for child care, and drastically reduced household income. A single parent may also want to leave a legacy, most likely in trust, to provide for a child's expenses until they reach maturity. Life insurance is the typical means to guard against those risks.

Additionally, because term life insurance is particularly inexpensive these days, many new parents can get enough coverage to also alleviate significant financial pressures on their surviving spouse by paying off a mortgage, funding a child's college education, or paying off personal debts, such as student loans.

If a parent has federal estate tax concerns, they may need to consider an irrevocable life insurance trust designed to exclude the proceeds of life insurance from their taxable estate.

New parents should not stop at life insurance, though. If a parent becomes disabled, whether by accident or illness, and cannot return to work with the same earning capacity, the family will need to replace that lost income. Disability insurance is the best way to guard against such a risk. The birth of a child is a good time to review the need for new or supplemental disability insurance.

4) Review Beneficiary Designations. If a parent has existing life insurance policies or retirement savings vehicles, like a 401(k) plan or individual retirement account, the birth of a new child is a good time to review beneficiary designations for those plans.

Typically, a new parent will have already named his or her spouse as the designated beneficiary of retirement plans or life insurance, but it is also important to provide for alternative beneficiaries in case the spouse does not survive the plan owner. People generally want to provide the most tax advantageous designations for beneficiaries and it is likely that a parent will simply

name all of their children as contingent beneficiaries of a retirement plan in order to stretch out the payout of an IRA or 401(k). This is wise because the most tax efficient pay out for retirement benefits is often to pay them out over the longest period, which is usually the life expectancy of the beneficiary.

There are two things to remember here. First, make sure that the parent's estate is not designated as a beneficiary under the plan. An estate cannot use the life expectancy payout method that is so beneficial for tax purposes. Second, consider designating a trust as the contingent beneficiary of retirement plans. Such a designation must be carefully considered because of the complex rules surrounding the types of trust that can qualify as a designated beneficiary, but it is worth the parent considering, especially if the retirement plan contains sizable wealth. A trust should be considered for the same reasons a parent should consider a contingent trust in their will. Parents generally want children to have the benefits of wealth without unfettered access until they are mature enough to handle their assets responsibly.

5) Start Saving for College. Almost all parents want to send their children to college someday, but only the select few will be able to afford it. With proper financial planning, however, any parent has the opportunity to pay for a significant portion, if not all, of the tuition bills on a tax-advantaged basis.

The tax code provides two primary tax advantaged savings plans. The first option is a savings plan under IRC § 529. These plans, appropriately called "529 plans," allow a parent or any other person to set up a state-sponsored fund to save for a child's education on a tax-free basis. While contributions to 529 plans are not deductible for federal income tax purposes, distributions from such plans are not taxable so long as the distributions are spent for the child's qualified higher education expenses. "Qualified higher education expenses" are defined in IRC § 529(e)(3) and include tuition, books, room and board for most students, and applicable fees for higher education.

Contributions to a 529 plan are subject to the federal gift tax. Thus, if a grandparent or parent contributes to a 529 plan in excess of the federal annual gift exclusion (currently $13,000), the contributor must file a federal gift tax return. But, IRC § 529 provides a great feature for big contributors to 529 plans. Any contributor can elect to treat a large contribution to a 529 plan as made in the year of contribution and up to four years immediately after the year of contribution. This allows a contributor of means to contribute five years of federal annual gift tax exclusions (currently $65,000) to a 529 plan for a child's college education without federal transfer tax consequences. The contributor can front load these five annual exclusion gifts to a 529 plan and give the plan a big head start toward funding a college education.

Louisiana taxpayers also receive two added benefits with a Louisiana sponsored 529 plan: a state income tax deduction and a matching contribution from the state government. Louisiana income tax payers may deduct contributions to a Louisiana 529 plan from their Louisiana income tax up to $4,800 per beneficiary, per year. These contribution deductions can also be carried forward to subsequent tax years.

The Louisiana plan also provides a matching contribution, between fourteen and two percent of the donor's contribution, which is paid for by the state government. The match percentage depends upon the account owner's income and the relationship between the account owner and the beneficiary. Note that these matching contributions are forfeited if the beneficiary goes to an out-of-state institution of higher learning.

Additionally, a parent can save for tuition through a Coverdell educational account under IRC § 530. The great advantages of the Coverdell account are that the account owner, typically a parent,

can direct the investments of the account and proceeds of the account can be used for primary and secondary schools, not just higher education expenses.

While these accounts offer the same tax advantages of a 529 plan, one can only contribute $2,000 per year into the account. There is no front-loading provision for Coverdell accounts either, so the $2,000 annual cap is a rigid one. With that cap, it's difficult to buy much private elementary or secondary education, but every little bit of tax savings helps.

6) Check Health and Dental Insurance Coverage. If a new parent enjoys the benefits of health or dental insurance, whether through an employer or otherwise, it is wise to check with the carrier of that insurance regarding coverage for the new child. Some plans may have a short window in which a parent can add a new dependent to existing coverage. If the new child is not added to the plan within that short window, the parent may not ever be able to add the child later.

The duties of a new parent can seem overwhelming at times, but the time spent in planning for a new child can significantly ease a parent's mind about the financial well-being of that child's future.