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July 2018 Oracle Financial Newsletter

Protect Your Heirs by Naming a Trust as IRA Beneficiary

Investing to Save Time Boosts Happiness Returns

I received a large refund on my tax return this year. Should I adjust my withholding?

What is the difference between a tax deduction and a tax credit?

The Oracle's Investment Letter

Providing Financial Planning and Life Insurance

Why People Buy Luxury Goods



It's common knowledge that brand-name items cost more money than their off-brand counterparts. But that doesn't prevent consumers from paying up. In fact, according to one study, the wealthiest

households (the top fifth of earners) spend approximately 65% of their consumption on luxury goods and 35% on necessities. By comparison, middle-income households spend 50% on luxuries and 50% on necessities. Even lower-income households (the bottom fifth of earners) spend 40% on luxuries and 60% on necessities.¹

Why do consumers choose to spend more money on luxury goods? The following factors help explain this financial behavior.

Ignorance is bliss

Consumers have the tendency to focus on the positive attributes of a product while ignoring its drawbacks. Non-luxury items are viewed as inferior, so it's easier to identify the negatives of those products over the brand-name ones.

For example, let's say you're in the market for a new phone. What sounds more appealing: an expensive smartphone produced by a well-known brand name, or a cheaper smartphone with comparative features made by a less-recognizable brand? Luxury retailers and their marketing departments rely on consumers to buy the more expensive products because of the legitimacy and quality associated with brand names. As a result, it's easier for consumers to ignore the higher cost of the pricier product and purchase it anyway, because it feels as though it's worth the extra money.

A mood booster

Do you treat yourself to a shopping spree when you're in a vulnerable emotional state? If so, you may be splurging on items you can't afford in order to boost your mood. On the opposite end of the spectrum, you may celebrate a big promotion or other life milestone by spending hundreds (or thousands) of dollars on a designer item. The instant gratification that

comes with extravagant spending is a feeling that some consumers can't pass up.

In addition to your emotions, your self-esteem can also determine how likely you are to buy luxury goods. Consumers who want to feel better about themselves might buy expensive items because they serve as status symbols. Whether or not you're able to afford it, a flashy product can act as a physical representation of your success in life and increase your self-esteem.

Knockoffs won't cut it

You've probably passed by a store or kiosk selling discount goods that are supposed to look like authentic luxury items. Even though they look like the real thing, there's a reason why you're likely to pass up knockoffs in favor of more expensive goods: authenticity. Purchasing a knockoff might save you money, but the knowledge that you're toting around a fake diminishes the meaning behind the purchase. In other words, buying an authentic luxury good also provides a sense of accomplishment or pride. Those feelings aren't the same when it's a knockoff item — treating yourself to a fake is really like not treating yourself in the first place. Consumers who continue to seek that sense of authenticity wind up spending more money on higher-end items again and again.

Shop smarter

If you want to rein in your spending, use good common sense when shopping. Ask yourself questions to help decide whether a purchase is really worth it. Why do you want this particular item? Will buying it affect you later? Can you afford it? Do you actually need it? If you can't live without it, do some comparison shopping to see whether you can score a better deal on a generic, nonbrand-name counterpart.

Avoid shopping when you want to reward yourself or boost your mood. But remember that it's okay to splurge from time to time as long as you plan your purchase and save for it accordingly.

¹ MarketWatch, July 21, 2017



While trusts offer numerous advantages, they incur up-front costs and often have ongoing administrative fees. The use of trusts involves a complex web of tax rules and regulations. You should consider the counsel of an experienced estate planning professional and your legal and tax advisers before implementing such strategies.

Protect Your Heirs by Naming a Trust as IRA Beneficiary

Often, tax-qualified retirement accounts such as IRAs make up a significant part of one's estate. Naming beneficiaries of an IRA can be an important part of an estate plan. One option is designating a trust as the IRA beneficiary.

Caution: This discussion applies to traditional IRAs, not to Roth IRAs. Special considerations apply to beneficiary designations for Roth IRAs.

Why use a trust?

Here are the most common reasons for designating a trust as an IRA beneficiary:

- Generally, inherited IRAs are not protected from the IRA beneficiary's creditors. However, IRA funds left to a properly drafted trust may offer considerable protection against the creditors of trust beneficiaries.
- When you designate one or more individuals as beneficiary of your IRA, those beneficiaries are generally free to do whatever they want with the inherited IRA funds, after your death. But if you set up a trust for the benefit of your intended beneficiaries and name that trust as beneficiary of your IRA, you can retain some control over the funds after your death. Your intended beneficiaries will receive distributions according to your wishes as spelled out in the trust document.
- Through use of a trust as IRA beneficiary, you may "stretch" IRA payments over the lifetimes of more than one generation of beneficiaries. Payments to IRA trust beneficiaries must comply with distribution rules depending on the type of IRA plan.

What is a trust?

A trust is a legal entity that you can set up and use to hold property for the benefit of one or more individuals (the trust beneficiaries). Every trust has one or more trustees charged with the responsibility of managing the trust property and distributing trust income and/or principal to the trust beneficiaries according to the terms of the trust agreement. If the trust meets certain requirements, the beneficiaries of the trust can be treated as the designated beneficiaries of your IRA for purposes of calculating the distributions that must be taken following your death.

Special rules apply to trusts as IRA beneficiaries

Certain special requirements must be met in order for an underlying beneficiary of a trust to qualify as a designated beneficiary of an IRA. The beneficiaries of a trust can be designated beneficiaries under the IRS distribution rules only if the following four trust requirements are

met in a timely manner:

- The trust beneficiaries must be individuals clearly identifiable from the trust document as designated beneficiaries as of September 30 following the year of the IRA owner's death.
- The trust must be valid under state law. A trust that would be valid under state law, except for the fact that the trust lacks a trust "corpus" or principal, will qualify.
- The trust must be irrevocable, or by its terms become irrevocable upon the death of the IRA owner.
- The trust document, all amendments, and the list of trust beneficiaries must be provided to the IRA custodian or plan administrator by October 31 following the year of the IRA owner's death. An exception to this rule arises when the sole trust beneficiary is the IRA owner's surviving spouse who is 10 years younger than the IRA owner, and the IRA owner wants to base lifetime required minimum distributions (RMDs) on joint and survivor life expectancy. In this case, trust documentation should be provided before lifetime RMDs begin.

Note: Withdrawals from tax-deferred retirement plans are taxed as ordinary income and may be subject to a 10% federal income tax penalty if withdrawn by the IRA owner prior to age 59½, with certain exceptions as outlined by the IRS.

Disadvantages of naming a trust as IRA beneficiary

If you name your surviving spouse as the trust beneficiary of your IRA rather than naming your spouse as a direct beneficiary, certain post-death options that would otherwise be available to your spouse may be limited or unavailable. Naming your spouse as primary beneficiary of your IRA provides greater options and maximum flexibility in terms of post-death distribution planning.

Setting up a trust can be expensive, and maintaining it from year to year can be burdensome and complicated. So the cost of establishing the trust and the effort involved in properly administering the trust should be weighed against the perceived advantages of using a trust as an IRA beneficiary. In addition, if the trust is not properly drafted, you may be treated as if you died without a designated beneficiary for your IRA. That would likely shorten the payout period for required post-death distributions.



"Time famine" is the feeling of being overwhelmed by the demands of work and life. Also known as time scarcity and time stress, this pressure is a "critical factor" in the rising rates of obesity.

Source: "Buying Time Promotes Happiness," PNAS, July 24, 2017

Investing to Save Time Boosts Happiness Returns

The more money you make, the more valuable you perceive your time to be — and the more time-strapped you may feel, according to University of British Columbia psychology professor Elizabeth Dunn.¹ So wouldn't it stand to reason that if you use some of your hard-earned money to buy yourself more time — for example, by paying someone to clean your house or mow your lawn — you might achieve a greater level of happiness? Indeed, that was the primary finding in a series of studies by Professor Dunn and other researchers published in the Proceedings of the National Academy of Sciences (PNAS).²

The discovery

The study's authors surveyed 6,000 individuals at diverse income levels in multiple countries, including the United States, Canada, the Netherlands, and Denmark. The surveys queried participants about whether they spent money on a monthly basis to hire others to take care of unpleasant or time-consuming daily tasks or chores — such as cleaning, yard work, cooking, and errand-running — and if so, how much they spent. Respondents were also asked to rate their "satisfaction with life" and report demographic information, such as their income level and whether they were married and had children.

Researchers found that across all national samples, 28.2% of respondents spent an average of about \$148 per month to outsource disliked tasks, while in the United States, 50% of respondents spent an average of \$80 to \$99 on services that save time. Across all studies, those who spent money to outsource disliked tasks and/or save time had a stronger life satisfaction rating. Findings were consistent across income spectrums; in fact, in the United States, researchers found a stronger correlation among the less-affluent respondents. The authors noted, however, that their studies did not include enough people at the lowest end of the income spectrum to attribute similar findings to this group.

Of course, correlation does not necessarily indicate causality, so the researchers designed a follow-up experiment to further test their hypothesis.

In this experiment, researchers gave a group of 40 adults \$80 each to spend over the course of two weekends. During the first weekend, they were to spend \$40 on something that would save them time, such as ordering groceries online and having them delivered. On the second weekend, they were directed to spend \$40 on a nice material purchase, such as clothes, board games, or a bottle of wine. On

average, those who spent money to save time reported better moods at the end of the day than those who purchased material goods. And according to the researchers, over time, the effect of regular mood boosts can add up to greater overall satisfaction with life.

In a third study, researchers asked respondents how they would spend an extra \$40. Just 2% indicated they would use the unexpected bonus to invest in time-saving services.

Perhaps most surprising of all the findings? Researchers polled 800 millionaires from the Netherlands about whether they spent money to save time. Despite the fact that these individuals could readily afford to hire others to take care of time-consuming tasks, only about half of them reported doing so on a monthly basis. Researchers surmise that the reason might be because such individuals feel guilty or don't want to be perceived as lazy for outsourcing chores they can easily do themselves.

The lesson

"If you have a lot of money and a lot of nice stuff, but you're spending your time doing things that you dislike, then your minute-to-minute happiness and overall happiness is likely to be pretty low," said Dunn in an interview about the research.³ In the PNAS report, the study's authors contend that this may be especially true for women:

"Within many cultures, women may feel obligated to complete household tasks themselves, working a 'second-shift' at home, even when they can afford to pay someone to help. In recent decades, women have made gains, such as improved access to education, but their life satisfaction has declined; increasing uptake of time-saving services may provide a pathway toward reducing the harmful effects of women's second shift."

The bottom line? If you can afford it, don't shy away from spending money to save time. Doing so is an investment that provides immeasurable returns in the form of overall well-being.

¹ "What Is Your Time Really Worth?" Elizabeth Dunn, TEDx Colorado Springs, December 1, 2014

² "Buying Time Promotes Happiness," PNAS, July 24, 2017

³ "A Psychology Expert Says Spending Your Money on This Can Boost Your Happiness," CNBC, November 10, 2017

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I received a large refund on my tax return this year. Should I adjust my withholding?

You must have been pleasantly surprised to find out you'd be getting a refund from the IRS — especially if it was a large sum. And while you may have considered this type of windfall a stroke of good fortune, is it really?

The IRS issued over 112 million federal income tax refunds, averaging \$2,895, for tax year 2016.¹ You probably wouldn't pay someone \$240 each month in order to receive \$2,900 back, without interest, at the end of a year. But that's essentially what a tax refund is — a short-term loan to the government.

Because you received a large refund on your tax return this year, you may want to reevaluate your federal income tax withholding. That way you could end up taking home more of your pay and putting it to good use.

When determining the correct withholding amount, your objective is to have just enough withheld to prevent you from having to owe a large amount of money or scramble for cash at tax time next year, or from owing a penalty for having too little withheld.

It's generally a good idea to check your withholding periodically. This is particularly important when something changes in your life; for example, if you get married, divorced, or have a child; you or your spouse change jobs; or your financial situation changes significantly.

Furthermore, the implementation of the new tax law at the beginning of 2018 means your withholding could be off more than it might be in a typical year. Employers withhold taxes from paychecks based on W-4 information and IRS withholding tables. The IRS released 2018 calculation tables reflecting the new rates and rules earlier this year. Even so, the old W-4 and worksheet you previously gave to your employer reflect deductions and credits that have changed or been eliminated under the new tax law.

The IRS has revised a useful online withholding calculator that can help you determine the appropriate amount of withholding. You still need to complete and submit a new W-4 to your employer to make any adjustments. Visit [irs.gov](https://www.irs.gov) for more information.

¹ Internal Revenue Service, 2018



What is the difference between a tax deduction and a tax credit?

Tax deductions and credits are terms often used together when talking about taxes.

While you probably know that they can lower your tax liability, you might wonder about the difference between the two.

A tax deduction reduces your taxable income, so when you calculate your tax liability, you're doing so against a lower amount. Essentially, your tax obligation is reduced by an amount equal to your deductions multiplied by your marginal tax rate. For example, if you're in the 22% tax bracket and have \$1,000 in tax deductions, your tax liability will be reduced by \$220 ($\$1,000 \times 0.22 = \220). The reduction would be even greater if you are in a higher tax bracket.

A tax credit, on the other hand, is a dollar-for-dollar reduction of your tax liability. Generally, after you've calculated your federal taxable income and determined how much tax you owe, you subtract the amount of any tax credit for which you are eligible from your tax obligation. For example, a \$500 tax credit will reduce your tax liability by \$500, regardless of your tax bracket.

The Tax Cuts and Jobs Act, signed into law late last year, made significant changes to the individual tax landscape, including changes to several tax deductions and credits.

The legislation roughly doubled existing standard deduction amounts and repealed the deduction for personal exemptions. The higher standard deduction amounts will generally mean that fewer taxpayers will itemize deductions going forward.

The law also made changes to a number of other deductions, such as those for state and local property taxes, home mortgage interest, medical expenses, and charitable contributions.

As for tax credits, the law doubled the child tax credit from \$1,000 to \$2,000 for each qualifying child under the age of 17. In addition, it created a new \$500 nonrefundable credit available for qualifying dependents who are not qualifying children under age 17. The tax law provisions expire after 2025.

For more information on the various tax deductions and credits that are available to you, visit [irs.gov](https://www.irs.gov).