fsa Financial Services Advisory
GROW WISER.

Second Quarter 2024
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Leftover Rollover

Suppose you've been contributing to a 529 college savings plan, but your son or daughter doesn't use all the money for tuition, books, etc. Do you just ask for the remainder of your money back?

Any contribution to a 529 plan is deemed to be a completed gift to the beneficiary, typically a child or grandchild of the donor. If you don't want to incur a gift tax, then you can contribute up to $18,000 a year, but you can actually make five years of contributions at once, $90,000 if you treat the contribution as if it was spread over a five-year period. (You would do this on IRS Form 709 for all five years). If you only want to contribute, say, $50,000, then you can apply $10,000 per year. After the contribution, the money grows tax-free and can be used to pay college expenses without being taxed.

But back to the first question; you have the money in the account, but now it looks like the son or daughter isn't going to use all of it. What do you do? You can indeed revoke the funds in the account, but that means they will be added back to your taxable estate, earnings will be taxable, and the IRS will assess a 10% tax penalty.

You can roll the money from one 529 plan to another one, tax-free, so that it covers another child or grandchild. That allows you to jump-start another child's or grandchild's college savings.

Finally, starting this year, you can transfer the stranded funds to a Roth IRA. However, there are restrictions. One of the most severe is that the 529 plan must have been maintained for at least 15 years, and the amount transferred must come from contributions and earnings made at least five years before the transfer. The Roth IRA must have the same beneficiary as the 529 plan, meaning that the money can't go back to an account held by the parents, grandparents, or other children. However, the owner of a 529 plan can change the beneficiary to another individual before the transfer.

In 2024, the aggregate amount transferred from the 529 plan to a Roth IRA for any individual cannot exceed $35,000, and the amount you can contribute in one year cannot exceed the annual regular contribution amount ($7,000 in 2024). That means the transfer might not be a good option for parents whose child suddenly decides to forego college. But for leftover funds, the money that would have gone to pay for college can be used to pay for future retirement expenses instead – and preserve its tax-free growth in the process.

From Our FSA Family

We have an announcement! I am pleased to report that Kim Basenback has agreed to join Ron Rough and me as a new partner/shareholder of FSA! We couldn't be happier!

Kim joined FSA in 2013 as a support advisor. Her exemplary work ethic and keen insights quickly garnered recognition from leadership and her peers. Through determination and a passion for financial planning, she steadily advanced, ultimately earning the role of Director of Financial Planning in 2018.

Kim's contributions have been instrumental in continuing to sharpen FSA's operations. She's responsible for many things which include enhancing our client experience process, creating the FSA Next offering for younger clients, spear-heading the implementation of a cutting-edge CRM (Client Relationship Management) system, and collaborating on innovative planning strategies. Kim has consistently demonstrated her effective-ness as a visionary leader.

Kim's role will carry on with three main components: continuing to work directly with new and existing clients, leading/managing our team of advisors, and keeping the firm up to date with new financial planning strategies and advice to clients.

In celebrating Kim's achievement, FSA not only recognizes her individual triumph but also reaffirms its commitment to fostering a culture where talent is nurtured and rewarded.

Jim Joseph
President

Green Book Wish List

Every year around this time, the current presidential administration releases a set of tax-related proposals, essentially a wish list for tax legislation for the coming year. These so-called "green books" are never passed in their entirety, but they offer a hint as to what kind of proposals will be working their way into and (possibly) through the next Congress.

The latest green book contains more than the usual number of proposed tax changes, including raising the highest corporate tax rate to 28% (currently 21%) and creating a new highest marginal tax rate of 39.6% for individual taxpayers with income above $400,000 a year.

For those who pay a net investment income tax (joint tax filers with $250,000 or more income; single filers whose income is above $200,000), the added tax rate on capital gains, interest, dividends, and rental income would go up from 3.8% to 5%. Employers would be required to withhold a 5% Medicare tax on individual wages paid in excess of $200,000 (up from the current 0.9%), and taxpayers whose net worth is above $100 million would pay a 25% minimum income tax on their total income, which would include taxing the unrealized capital gains on their investments (unlikely for most taxpayers).

The proposed corporate tax changes would also include a 4% excise tax on share repurchases by publicly traded companies (up from 1%) and a higher corporate alternative minimum tax rate of 21% (up from 15%). And companies would be prohibited from deducting "excess" compensation for any employee earning more than $1 million a year.

Interestingly, the green book offers no proposed change to the estate tax exemption, possibly because, at the sunset at the end of next year, the generous current exemption will automatically drop to somewhere around $6-7 million. But the green book does propose to tax heirs on any gains of appreciated property that they inherit at capital gains rates. Currently, the heirs would get a step-up in basis, meaning that the capital gains obligation would go away as the tax basis resets.

It's worth repeating that this is a legislative wish list and not something that is currently included in a tax bill in Congress. But we can expect to see some of these proposals debated in the House and Senate throughout the year.

Debt Rising, Consumption Falling?

By all accounts, the U.S. economy is humming along on all cylinders. Inflation is down (but not out), unemployment is still low by historical standards, and GDP growth is healthy. Worker wages continue to rise. What's there to be concerned about?

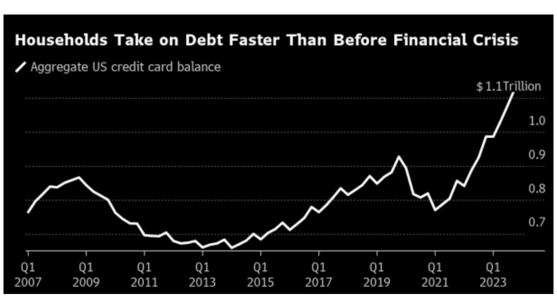
Consumer debt is an interesting area to look at. Since the pandemic, U.S. families have gone on somewhat of a spending spree beyond what they can afford out of pocket. The result is a rapid growth in their aggregate credit card balance, far more rapid than we've experienced historically. According to the Federal Reserve Bank of New York, American consumers are now carrying $1.1 trillion in revolving credit on their credit cards, and the growth curve is steep.

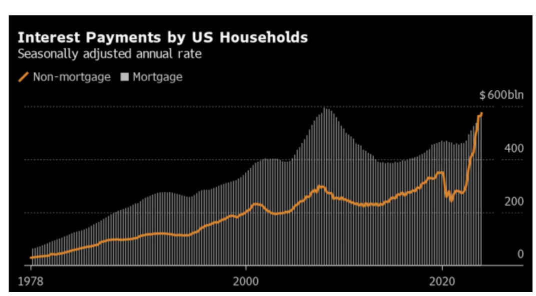
This might not have been concerning when interest rates were low, but today's higher rates mean that it has become increasingly expensive to pay the monthly charges that are accruing so rapidly. The typical charge on a credit card is now a record 22% of the money owed.

If you add in mortgage debt, whose interest rates have recently ballooned as well, American consumers are now looking at an estimated $600 billion in annual interest payments. Most of us know that consumer spending is a big part of the economy's health and growth; some economists are worried that so much money sucked out of the pockets of American consumers will depress their ability to keep buying products and services at recent rates.

One might argue that rising wages will address this issue, but remember that this explosion of debt has been happening during this period of rising wages, meaning that many consumer balance sheets are falling behind even as their income goes up. In fact, real compensation (wage growth minus inflation) has amounted to less than half a percent a year since the pandemic. Workers are basically coming out even between employers putting more in their pockets and inflation making the things they buy increasingly expensive.

Should we be worrying about this? It probably depends on whether you believe that American consumers will continue borrowing and spending (economic growth!) or they'll start cutting back and paying down debt (healthier consumer balance sheets but stalled GDP growth). Neither option would be fatal to the stock market in the long run, but it's worth noting that the current debt binge is ultimately unsustainable. Something will have to change.





What Does the Realtor Settlement Mean for Us?

You might have read about what the press is calling a seismic shift in real estate commissions and how people are going to be paying their realtors a lot less to sell their homes going forward.

The changes are the result of a $1.8 billion lawsuit filed in Missouri by a group of home buyers who claimed that the National Association of Realtors (NAR) and two large realtor organizations were conspiring to keep broker commissions at the industry standard 6% when a truly competitive marketplace would have produced commissions in the 3-4% range. The settlement impacts more than a million realtors and paves the way for home sellers to shop the prices (commissions) that they would pay to a listing agent and the ultimate sales agent.

As a result, real estate commissions are expected to fall 25-50% on average for the 1.6 million real estate agents across the U.S. marketplace. In dollar terms, the average-priced American home for sale ($417,000) would have paid $25,000 in brokerage fees before the settlement. That would fall by between $6,000-$12,000.

The NAR agreed to pay $418 million over four years to resolve the price-fixing allegations. But perhaps more painfully for the organization, the settlement will also provide more market share to flat fee and discount brokerage operations which had been forced to do business outside of its Multiple Listing Service. Independent (non-NAR) members will now, through the settlement, be allowed to list properties on the MLS, and they might (still up in the air) be able to advertise a lower commission.

Analysts are still sorting through the real-world impact. But the ruling opens the door to buyers paying some or all of the (negotiated) brokerage fees for the service of finding the property, rather than the seller being on the hook for the entire brokerage fee. Nobody seems to expect the ruling to produce a rush to sell homes and properties; in fact, paradoxically, it could reduce sales activity. Why? Buyers may not always have the funds to pay a broker out-of-pocket; they typically rely on the mortgage loan for the purchase funds. Current lending practices don't allow brokerage fees to be added to the cost of the home, so the brokerage fees would have to be somehow added to the price of the house to be covered by the loan.

New Highs. Now What?

Up until April, we've been reading headlines telling us that the stock market has reached all-time highs, something that never happened in 2023. Many investors will think that means that there's a high likelihood that we'll see a downturn in the near future. The markets have nowhere to go but down from here, right?

There is a kind of logic to this assumption, but history says that it's actually wrong. Since 1973 (the modern stock market), the markets have achieved an average 10.1% positive return over the 12 months following an all-time high, which is actually higher than the average 12 month return from any random day during that time period (+9.5%). Going back further, for shorter time frames, since 1950 80% of record highs have led to at least one more record high the following week, and the markets generally hit a new all-time high (again, on average) every 19 days.

If you go back 60 years (since 1964) the average one-, two-, and three-year returns after a record high are 12%, 23%, and 39% (these are aggregate, not annual returns), which is surprisingly close to the 12%, 25%, and 38% average aggregate returns for all other one-, two-, and three-year time periods.

This is not to say that the markets will not or cannot go down from here; they can and they might (take April for example). But the most consistent thing about the markets is that, no matter where you start, the overall long-term trend has been positive, and all-time highs are, perhaps surprisingly, no exception.

AI Everywhere

Artificial intelligence is unlikely to replace plain old human intelligence any time soon, but you might be surprised at how many programs are now using it to make our lives easier. If you thought that having a human-like interaction with ChatGPT and DALL-E was the beginning and end of today's AI, then you're missing a lot of new and interesting functionality.

Many of the new applications let you speak your requests rather than type them. If you're of a certain age, you might now be using Snapchat to exchange messages, as well as share videos and images. Microsoft's Bing, Ask AI, Alexa, Google Assistant, and Apple's Siri are all being called virtual assistants because you can now ask them to do searches and perform tasks like start your car (assuming it has smart features built-in), make reservations, and give directions. Google Maps now lets you speak the location you want to be guided to.

Similarly, FaceApp, Lensa, and Facetune now leverage AI to help novices edit the pictures they've taken, and Lensa also edits videos. (In this new era, you can no longer believe the pictures and videos that you might see on social media.)

If you want to get creative with images, consider StarryAI which creates artwork based on your simple text prompt. Additionally, you can look at the result and ask for modifications, from hyper-realistic to dreamy surrealistic.

Want to learn another language? Consider Duolingo which automatically paces lessons in dozens of languages based on your current fluency and progress. ELSA Speak, meanwhile, helps users perfect their English-speaking skills, adapting to the user's accent and color-coding (red, yellow, and green) how close a user is to the acceptable pronunciation.

Are you frustrated with helping your kids with homework assignments that have no relation to anything you learned in school? Turn to Socratic which lets you take a picture of the assignment page with your phone, and you get an AI-generated explanation of the assignment and help completing it.

A relatively new program, available on Apple phones, is FitnessAI which uses artificial intelligence to generate personalized workouts that set the number of reps and weights for each exercise and tracks programs over time.

It's easy to wonder where all of this is going, with new announcements of AI-powered robots and human-like robots with human-like facial expressions. Artificial intelligence isn't taking over the world, but it might be successful in taking over a number of annoying tasks with more human-like assistance.

Profits and More Profits

It isn't being widely reported, but aggregate U.S. corporate profits reached record levels in the fourth quarter of last year, increasing 4.1% after going up 3.4% the previous quarter. The net profit margin for companies in the Standard & Poor 500 Index reached 10.7%, and the tech-heavy companies on the NASDAQ exchange reported a 23% aggregate profit over the fourth quarter.

Is this sustainable? Overall, corporate earnings rose 9% last year, which is higher than the 3.3% growth in the economy as a whole. Generally speaking, corporate revenues grow at roughly the same rate as the economy overall, so one might expect future revenues to fall back in line. But the interesting part of the picture is that companies are paying higher wages and still generating greater profits from the products and services they offer. At the same time, inflation is stuck at around 3-4% which suggests that companies have the ability to raise their prices without much pushback from consumers and are able to increase profits even as expenses go up incrementally.

This economic picture is generally bright for stock market investors but perhaps not as bright for people who are rooting for inflation to come down.

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