Financial Services Advisory
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Inherited IRA Distribution Rules

There was a time, back before 2020, when the rules covering people who inherited traditional IRA accounts were simple. Before the SECURE Act was passed, people could spread out their distributions from these inherited retirement accounts over their lifetime, using a simple mortality table. (No, not totally simple, but . . .) These were the famous "stretch" provisions which made it possible to reduce the annual tax bite on the amount received.

Then SECURE Act forced the IRA inheritors to take all the money out within ten years, but under the original rules, they could wait until the day before the ten years expired to take a full distribution. That might not be optimal from a tax standpoint (bunching all the distributions in a single year would put you in a higher tax bracket), but at least it was uncomplicated.

Then came IRS interpretations, and the IRS has finally issued finalized rules, which have made the lives of some IRA inheritors weirdly complicated.

Under the rules, if a person inherits an IRA from someone who died before he/she was taking required minimum distributions (RMDs), then that person has the flexibility to take the money out at any time during the 10-year period, probably taking some amount each year to smooth out the taxes. The requirement is all the money must come out within ten years.

But if the deceased IRA owner had been taking required minimum distributions, then the beneficiary would fall under an "at least as rapidly" (ALAR) rule, which means that the beneficiaries would have to continue taking annual required minimum distributions at least as high as what the previous owner had been taking. At the end of the tenth year, any remaining assets would have to be distributed in full.

As before, the distributions are calculated as a percentage of the value of the IRA as of December 31 of the prior year, and distributions are required by December 31 of the current year.

The IRS conceded that the rules were muddled prior to the new finalized roles and agreed to waive all penalties for not taking these distributions during the 2021-2024 period which essentially waived the requirement to take them at all. People who did not take those distributions may do so, but that is optional; and the decision should probably be made in light of tax considerations.

As they weigh their options, they will probably wish that the account owner had converted their traditional IRA to a Roth IRA. The Roth accounts don't require distributions up to the tenth year, and there are no taxes on those distributions.

This rule clarification is on our radar. The financial advisors and operations team are discussing how to best track and handle these new required distributions moving forward so you can continue focusing on living your life while we handle your accounts.

From Our FSA Family

One for You!
One for a Friend!

You may have noticed that you received two copies of FSA's quarterly financial planning newsletter. This is by design. In previous newsletters, we have shared how we've improved our company over the last few years by adding new software, creating new investment strategies, and expanding our team. Our initiative to improve "inside the house" has two goals: to better serve our clients and to expand our reach to help more families. The second copy of the newsletter is to help with the latter.

We love the feedback we receive from our clients, especially about how much they enjoy reading the quarterly newsletter. So this time, we're sending you two copies to share the wealth. If you know someone who could benefit from a trusted financial advisor (such as your children, siblings, or close friends), we encourage you to pass along the second copy.

How do you know who would benefit from our services? If you know people who need help preparing for retirement, just received a windfall, or have built a nest egg but struggle with market volatility or find managing their finances a chore they want to delegate to a professional, then they could benefit from working with a financial planner like those at FSA.

We want to express our sincere gratitude for being the best clients. We truly appreciate the trust you place in us to help you manage the uncertainties of the world. We are grateful for our partnership and excited for the continued journey ahead!

How Will Congress Fix Social Security?

It seems like every news cycle includes an article about how the Social Security trust fund is about to run out of money. "About" may be somewhat of a misnomer. Estimates vary and change as the economy goes through its ups and downs, but the latest estimate suggests that the trust fund will run out of money by 2035, or in 11 years.

That doesn't mean that, a decade or so down the road, we will witness the abrupt termination of Social Security benefits for seniors who qualify. The program receives its revenues from two sources: the money paid in by workers and businesses through their FICA contributions and, where this is insufficient to pay for the benefits, from the trust fund to make up the difference. Roughly 20% of Social Security payments, in aggregate, come out of the trust fund each year. The most recent estimate is that if nothing is done and the trust fund is allowed to be depleted the Social Security Administration will pay 83% of the benefits that you see on your benefits statement.

It's unlikely that Congress will decide to ignore the problem; the more relevant question is which of the many proposals will be acted upon. One is to simply raise the full retirement age from 67 to 68 immediately and then bump it up progressively by two months each year thereafter. That would fill 44% of the funding gap and represent a roughly 13% stealth reduction in benefits to future retirees. A second similar proposal would index the Social Security retirement age to rising lifespans, which would address 20-25% of the funding gap.

Another set of proposals would lower the annual inflation adjustments for retirement benefits by switching to a different (less generous) inflation measure. This would fill an estimated 23% of the gap, but it might raise political hackles since most economists say that the current benefits increases don't keep up with inflation as it is.

There are several proposals to change the tax cap on FICA payroll taxes, that is, the maximum amount of income that is subjected to FICA assessments. One would raise the cap from $168,600 to $215,000 of personal income, which would fill roughly 35% of the funding gap. Another proposal would subject all earnings to Social Security taxes, which would fill 86% of the funding gap. This might be a political winner, since only 6% of American taxpayers would be affected. Alternatively, there's a Congressional proposal to raise the 6.2% payroll tax rate to 7.2% and leave the cap where it is (indexed to inflation). That would reduce the funding gap by 64%.

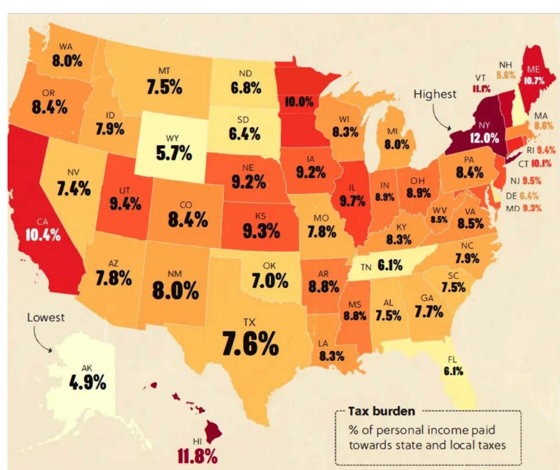
There are several other proposals on the table, including ones that reduce benefits for the highest-earning 25% of Americans, taxing contributions to retirement plans such as 401(k) programs, and creating a means test for receiving Social Security benefits (meaning that people who are receiving higher income in retirement would see their Social Security checks reduced). However, these proposals have a minimal effect on addressing the gap.

Which will ultimately be adopted? We'll have to wait to find out. Look for Congress to consider all of these ideas in the next few sessions and a possible combination of multiple proposals to reach the House and Senate floor. As with many other political issues, Congress will most likely kick the can down the road until the last possible minute. That said, with almost 68 million Americans currently receiving Social Security benefits, this is one topic that Congress must address before the trust fund runs dry.

State Tax Rates in Context

Several U.S. states have become attractive destinations for retirees, due to the fact that they don't charge state income taxes. Florida, Nevada, South Dakota, Tennessee, Texas, Washington, and Wyoming fall into this thrifty category. New Hampshire is technically part of this category, but the state charges a flat 4% tax on interest and dividend income.

So those states are the cheapest places to live, from a tax standpoint, right? Actually, when you look at the bigger picture, there are thriftier places to live, taxwise. Why? Because you also have to consider property taxes and state sales and excise tax in the equation.



When you look at the percent of an average person's income that is paid toward total state and local taxes, you discover that the least expensive states from a tax standpoint is Alaska which assesses just 4.9% of the income of its average citizen. Florida and Tennessee are near the bottom (6.1%), but Texas (7.6%) and Washington (8.0%) might not be the thriftiest retirement destinations.

No reader will be surprised that New York (12.0%) is the overall state tax leader, followed by Hawaii (11.8%), Vermont (11.1%), Maine (10.7%), California (10.4%), and Connecticut (10.1%). Retirees who want to live on the coast and still pay low taxes might consider Delaware, which assesses an overall 6.4% tax rate.

The Exceptional American Economy

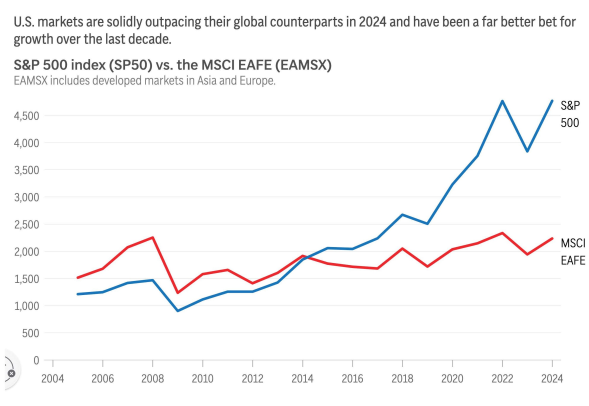
Remember the good old days when the U.S. economy was growing at a 2.5% clip and when it accounted for 80% of the global economy's growth? When jobs were plentiful because the unemployment rate was below 5% and prices were relatively stable because the inflation rate was down below 3% a year? When manufacturing output in America was routinely experiencing 1-3% growth and the average manufacturing worker was living comfortably on the equivalent (in today's dollars) of $98,846, including pay and benefits.

Remember when the United States was routinely posting the greatest economic growth rate in the world, by a wide margin? Remember when American stock market performance was outpacing all other markets, by a wide margin, and the dollar was strong against all other currencies?

You don't have to have a long memory to recall this golden age of American prosperity because those statistics are all from today. U.S. economic growth is running at 2.5%, well ahead of the Japanese, Canadian, French, Italian, English, and German growth rates (see chart). Meanwhile, since 2019, the S&P 500 Index of the largest American companies has delivered 48% market gains, compared to just 10% for developed markets outside the U.S. (the MSCI EAFE index.)

The International Monetary Fund's latest report notes that all countries have been dealing with the same challenges of post-pandemic inflation, but a combination of strong growth in the U.S. labor force and strong productivity growth fueled by an innovative corporate sector has once again driven America to the head of the economic pack. The Peterson Foundation economists actually found that, ju-jitsu-like, the American economy was able to turn the pandemic to its advantage, moving millions of lower-income workers to better jobs providing more income security.

It's a curious fact about human nature that we can't see the good times in real time, at the moment; we only recognize and appreciate them (and wish they were back) when we're looking in the rearview mirror after the passing of a decade or more. That means that sometime in the late 2030s, people will look back at today's American economy and marvel at how good we had it, without knowing that most of us never realized this at the time.



Summer Olympic Stats

The Summer Olympic games have come and gone. As you know, Paris was the host city, but many of the events happened in other French venues. For example, the equestrian events were held on the extensive grounds of Versailles, where the French kings decanted for their summer vacations.

Historically, a few nations have dominated the medal award podium and heard their national anthem after the results were announced. Excluding the 2024 Olympics, the United States has won a total of 2,629 Summer Olympics medals, by far the most, including 1,061 golds, 830 silvers, and 738 bronzes. Second is the Soviet Union, with 1,010 total medals (395 gold) followed by Great Britain (916 total, 284 gold), France (751, 223), China (636, 263), Germany (655, 201), Italy (618, 217), Australia (547, 164), and Hungary ((511, 181).

But the interesting thing about these totals is that the United States has participated in 28 of the 29 summer games (boycotting the Moscow Olympics in 1980), while the Soviet Union has only participated in 9, Germany in 17, and China in 11. If you were to rank countries by the number of medals earned in contests that they actually competed in, the order would be (using round numbers): Soviet Union (average of 122 medals per games attended), United States (94), East Germany (82 over just five summer games), Russia (71 average over just six summer games), China (58), Great Britain (32), France (26), Japan (22), Italy (22), Australia (20), and Hungary (19).

In the winter games, the runaway leader is Norway with 405 total medals, followed (surprisingly) by the United States (330), Germany (267), Austria (250), Canada (225), the Soviet Union (194), Sweden (176), and Finland (175). Some of the discrepancies are interesting. Equatorial Brazil has won 143 total summer games medals and never medaled at the winter games. Cuba, with 235 summer medals, has also never had a citizen on the winter podium, and Turkey (103 summer medals), Kenya (113), Argentina (77), South Africa (89), and Jamaica (88) are similarly winless in the winter games.

Older Cars, Thriftier Drivers

There are two kinds of car owners in this world, the people who buy a new car every few years and the people who continue driving their older cars until the transmission drops out onto the pavement. A recent study shows that a growing number of people are shifting from the former to the latter, and the trend has been going on for a while. In 1977, only 16.9% of cars on the road were at least ten years old. Today that figure is just under 45%.

What's going on? There are several factors at play. One is the increased durability of cars manufactured in the recent past vs. a decade or two ago, which means they can stay on the road for many more miles. A vehicle owner with a reliable car might be hesitant to trade it in for a new model that is pricier (especially at today's interest rates) and which also has more built-in electronics that can malfunction and increase repair costs. The average price of a new vehicle is $46,660, compared with $39,950 three years ago. Repair and maintenance costs are up 8.2% in the past year alone, and insurance prices are up a painful 22.2% over this time last year.

As more drivers are squeezing more miles out of their existing cars, it has become increasingly common to find odometers above 200,000 and even 300,000 miles. This, of course, assumes that the car is durable enough to last that long. Lexus and Toyota vehicles have a reputation for giving their owners the fewest repair problems, while electric vehicles in general have been less reliable.

But, as mentioned earlier, it all comes down to preferences. The financially-savvy person might compare repair costs on the existing vehicle with the cost of a new one and conclude that repair is the less expensive option. Others like the idea of hitting the road in a shiny new ride.

More Tech, More Disposable

Today's automobiles are becoming increasingly disposable, according to a new research report by insurance analyst CCC Intelligent Solutions. The report found that more than 20% of vehicles involved in road accidents are declared to be "totaled" by the insurance carriers, rather than approved for repair.

We can easily understand one reason: Today's autos come with a variety of expensive technology, and much of it is found on the vulnerable outside of the car. The Advanced Driver Assistance Systems (automatic braking and lane-keeping assistance) rely on external sensors and cameras that are easily damaged in crashes. To repair these fixtures, technicians have to install, test, and calibrate the equipment, adding to the already high costs of the technology itself. The American Automobile Association has estimated that these high-tech driving aids now account for 38% of repair costs, which means that repairs are no longer about replacing fenders and door panels.

But new, expensive tech isn't the whole reason that cars are increasingly disposable. The value of used cars has declined since the peak of the pandemic, which (by the peculiar financial dynamics of the auto insurance industry) means that insurers are less incentivized to fix vehicles.

And beyond that, today's "disposable" (written-off) cars are no longer broken up for scrap metal and parts. Buyers from emerging markets are now purchasing the discarded American cars and restoring them, so they can be sold in their domestic markets, without the high-tech safety equipment. Their lower labor costs (meaning lower costs of repair) have increased the value of totaled vehicles at auction, allowing insurance companies to recoup more of their outlays whenever they declare that a car is too expensive to fix.

The CCC study and others indicate that accident rates have not declined despite all the fancy new technology. The lesson may be that drivers need to make sure they have adequate insurance to cover the difference between a settlement from the insurance company and the cost of a new vehicle.

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