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www.FSAinvest.com
(301) 949-7300

# Your Surprising Longevity

How long do you think you're going to live? How does that compare to other countries?

One of the most surprising pieces of news to many people is that they are likely to live longer (perhaps much longer) than they expect. And the life expectancy statistics are highly misleading.

Let's start with the life expectancy numbers. On average, an American male will live 74.5 years, and an American female will live 80.2 years. Those are actually lower than many countries. Males and females in Japan are expected to live 81.6 and 87.7 years, respectively; Australian men and women have average lifespans of 81.2 and 85.3 years. Canadians, all Europeans, Israelis, Costa Ricans, Chileans, Chinese, and even Saudi Arabians and Cubans, on average, live longer than Americans.

Of course, there are countries with lower life expectancies, including African nations like Chad (51.2 and 54.4 years), Nigeria (52.5 and 53.3), Congo (57.8 and 61.7), and Kenya (60.5 and 65.1).

So how are these statistics misleading when we're projecting our own lifespans? The life expectancy tables include people who die in infancy and in their teens and 20s and so forth, which is somewhat irrelevant to somebody who has, for example, managed to get past all that and live to age 65. According to the U.S. Center for Disease Control, a 65-year-old woman is expected, on average, to live an additional 20.8 years, taking her beyond her 85th birthday. A 65-year-old American man is expected to live an additional 18.2 years, taking him into his 80s.

But remember, once again, those are averages, which means they include people who die a few days after they celebrate their 65th birthday. Baylor University recently crunched a lot of demographic numbers and determined that a 65 year old currently has a 24.2% chance of living to age 95 and a 9.6% chance of living to (or beyond) 100. If you were to do the same math for couples, those numbers would roughly double; a married couple, both age 65, would have an almost 20% chance that one of them would live to see his or her (more likely her) 100th birthday.

We often hear objections from people saying they don't need to plan for such a long retirement because they aren't likely to live that long. The numbers tell us otherwise.

# *From Our FSA Family*

Hi everyone! Wow, 2023 has certainly been eventful between ensuing inflation, interest rate hikes, and banking crises. What else is in store this year!

Speaking of banks, the current uncertainty in the banking industry has famously caused some depositors to pull their money from their lending institution, even though their money is insured up to $250,000 per account. Some clients have expressed worry about their money at Charles Schwab, so we wanted to talk a bit about SIPC insurance.

Banking assets are protected by the Federal Deposit Insurance Corporation (FDIC), while brokerage assets are comparably protected by the Securities Investor Protection Corporation (SIPC). SIPC's coverage limits are twice as high as the FDIC's, up to $500,000 per securities account. So, if a person has a traditional IRA, a Roth IRA and a taxable account at a custodian like Schwab, each would be protected up to $500,000. Similarly, if a married couple each has an individual account, plus a joint account, all three accounts would be insured for up to $500,000 each through SIPC.

When does the protection kick in? If a custodian becomes insolvent, then SIPC will ask the court system to appoint a trustee to liquidate the firm. In most cases, however, investors will recoup their investments because the government will broker the sale of the custodian or broker-dealer to another party, which will take over custody of the accounts and render them safe again. In addition, brokerage firms are required to keep customer funds in accounts separate from their own, which serves as a backup check and balance against insolvency losses.

As a result, if someone has more than $500,000 in one brokerage account, chances are high that they won't lose any money even if the custodian or brokerage firm is forced into liquidation. However, if the firm is unable to self-liquidate or there are no buyers on the horizon, then SIPC will be the guarantor of last resort.

We hope that provides some clarification on SIPC insurance. As always, we are here if you have questions. Have a great fall!

# Backdoor Loophole

Maybe this financial planning strategy is a loophole, and maybe it should be closed based on current tax policy. But the recent tax act, and several previous ones, failed to prevent people from making so-called "backdoor" Roth IRA contributions.

The strategy is a workaround, around the fact that the IRS says that individuals with more than $153,000 in adjusted gross income, or couples earning over $228,000, are not permitted to contribute to a Roth IRA. Why would they want to? Unlike a traditional IRA, contributions to a Roth are not excluded from taxable income (aka after-tax contributions). But the money contributed to a Roth, and all the appreciation of its investments, can be taken out tax-free upon retirement. If you think taxes are going up, or you want more control over your taxable income during your retirement years, then a Roth account can be a handy part of your overall retirement assets.

So how does this "backdoor" strategy work? Somebody whose income is above those thresholds can still contribute to a Roth account, under current rules (which have been threatened over and over again but are still perfectly legal) by first making a (nondeductible) contribution to a traditional IRA account. There are no income limits to who can make this contribution, which is limited to $6,500 a year (or, if your taxable income is lower, then your taxable income), with a $1,000 additional legal contribution for people 50 or older by the end of 2023.

Then you would contact your IRA administrator to convert that contribution to a Roth IRA. That converts the contribution from an account that can create tax-deferred growth to an account that can create tax-free growth without any additional tax consequences.

The conversion can be a rollover from your traditional IRA into the Roth IRA, but a better strategy is a trustee-to-trustee transfer where the traditional IRA provider would send the money directly to the Roth IRA provider (often the same entity).

Some individuals may benefit from a so-called 'mega backdoor' Roth contribution which would generate higher contributions to the Roth account. This supersized version of the backdoor Roth works for individuals who have a 401(k) plan at work; an individual could put up to $43,500 of after-tax dollars

into their plan, and up to $22,500 in deductible contributions, and then roll that money right back out into a Roth IRA or Roth 401(k).

This process can be complicated, so it helps to have a professional involved, especially as not all 401(k) plans permit the strategy. The plan has to permit in-service distributions while you're still working at the company or let you move money from the after-tax portion of your plan into a Roth 401 (k) plan administered by the company. Additionally, not all 401(k) plans allow after-tax contributions.

For at least the past three years, there have been proposals in Congress to terminate these 'backdoor' strategies, and it's logical to imagine that our elected representatives will eventually close this "loophole," but in the meantime, feel free to enjoy the benefits of it while you can.

# Rates Moving Rates

The U.S. Federal Reserve Board once again raised the so-called fed funds rate, the rate that our central bank charges lending institutions on overnight loans. Does anybody care?

Most of the attention in the press centers around what this tells us about how the Fed economists and governors are thinking and whether there will be more rate hikes and what the impact will be (or not be) on the inflation rate and the prospects of a recession. As it turns out, this particular rate hike was relatively modest (a quarter of a percentage point to 5.5%) and anticipated well in advance.

But there are more mundane impacts that the fed funds rate can have on those of us who live normal lives. Perhaps the most direct is a return on savings accounts and cash. Not long ago, before the Fed decided to attack inflation, people were earning around half a percent a year on their parked cash. Today, it's possible to shop for certificates of deposit yielding 5%. There is no direct connection between the Fed actions and short-term interest rates, but they do tend to move in tandem.

Another impact is credit card debt. When the Fed raises rates, credit cards raise their rates accordingly. Auto loans and personal loans will charge higher interest rates, and most of us have watched mortgage rates move higher in loose lockstep with the Fed's policy decisions.

The reason the U.S. central bank moves these rates up or down is directly tied to the behaviors it wants to influence. Right now, with these hikes, Fed economists think that this is a good time to encourage saving and discourage borrowing and leverage, basically cooling off the pace of the economy and reducing the demand for goods and services that cause inflation to remain persistent.

And it's not alone. The European Central Bank also raised its equivalent rate by a quarter of a percent, as did the Bank of Canada. Savers rejoice; borrowers despair.

## Spending in the Golden Years

The normal retirement planning models say that when we retire, we will spend the same amount of money out of our retirement portfolios each year on living expenses, travel, eating out, etc., with that total amount only rising each year as inflation makes all of those things incrementally more expensive.

But is that actually true in the real world? A recent report by the RAND Corporation examined the spending patterns of older Americans who participated in the University of Michigan's Health and Retirement Survey. RAND researchers found that for single retirees, real spending declined after age 65 at a rate of about 1.7% a year; for coupled retirement households, the decline was 2.4% a year.

There are several possible explanations for this. One is that people might find their living expenses less affordable as they get older. But the researchers concluded that this was not a factor because they found that the wealthiest group of survey participants showed the same spending declines as those with less wealth. In fact, they found that as retirees got older, across all wealth categories, they spent an increasing share of their budget on gifts and donations.

A better explanation, proposed but not proven in the research, is that younger retirees are more vigorous and more inclined to take trips and eat out in their 60s and early 70s than they are when they get older. They might also become less interested in luxury goods like new cars and clothing as they age.

The median retiree household age 65-69 spent $28,505 (single) or $53,990 (married) a year, while retirees in their 80s spent $26,094 and $38,885 respectively. But of course, there was considerable variation in this number; some retirees expect to spend extra for a more lavish lifestyle than others. The study broke down expenditures by category and found that trips and leisure expenditures fell the farthest as people got older (see chart), while healthcare expenditures were surprisingly stable, especially for coupled households. In all age categories, housing was the biggest budget item (23-25% of the total budget) followed by food (16-19%) and utilities (12-17%).

This healthcare statistic might surprise some people who had assumed that later in life people will have to allocate dramatically more to medical expenses than they did when they were younger and more vigorous. The study referenced an earlier study which found that, for most individuals, the last year of life will typically engender a relatively affordable $6,800 in out-of-pocket payment for doctor and hospital visits; indeed, the healthcare percentage of a household's budget averaged just 14% for people over 80 (compared with 9.4% for the youngest retirees). A relatively small number of people, roughly 10% of the sample, accounts for 42% of the out-of-pocket healthcare spending in the later years of life, and the presumption is that much of this can be addressed by buying a long-term care insurance policy.

How does FSA model retirement expenses in our financial plans? As you probably know, we tend to take the conservative route by assuming your current expenses will continue to increase at the rate of inflation. However, we typically account for some expenses falling off when clients reach their 80s, such as travel expenses or downsizing their homes. For healthcare, we assume these expenses increase at a 5% inflation rate as shown historically. Nobody can know for sure what your spending or inflation may be in the future, which is why we find it to be prudent to prepare for the worst and hope for the best when illustrating 30+ years of retirement.

## Taxes on the Horizon

Every year, taxpayers and financial professionals brace for a new round of changes to the tax laws, and it's a huge understatement to say that constant fiddling with how we are taxed makes planning far more difficult than it should be. To make things even more complicated, the more recent tax changes are now created in 10-year increments which means they revert to the previous tax rates and laws upon expiration.

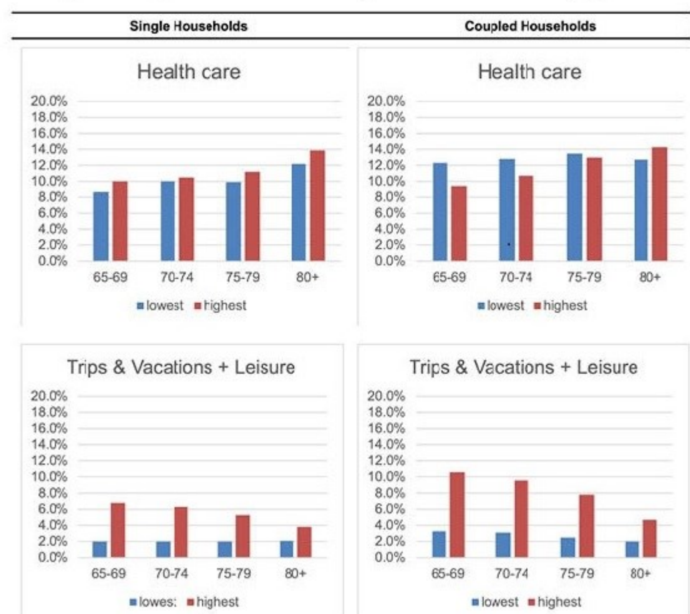
So, what's currently on the horizon? You probably know that the estate tax exemption, currently $12.92 million per person and just under $26 million per couple, is due to sunset in 2025. When the current exemptions were created in the 2017 Tax Cuts and Jobs Act, that seemed like a long way off. Today, one doesn't need a calculator to realize that in two short years estate taxes will apply to all amounts over $5 million indexed for inflation.

At the same time, the 40% maximum gift and estate tax rate will go up to 45%, the highest individual tax rate will go up to 39.6%, and the doubling of the standard deduction will expire.

There are some new tax proposals in the early stages of introduction that professionals are watching. One of them would change the capital gains tax for investors earning at least $1 million a year from the current upper limit of 20% to 39.6%. Another is a minimum tax rate of 25% on all households with a net worth of at least $100 million, compared to an average effective rate of 8% for the wealthiest taxpayers currently.

Will any of this happen? Who knows? It's entirely possible that there will be a major tax "reform" package working its way through Congress by this time next year which might push the sunsets back another decade. Or they might simply tinker with the rates, exemptions, and rules, capturing some lobbyist money along the way. There's an old cartoon which shows a TV commentator cheerfully announcing that "Congress has just simplified the tax code by adding another 1,000 pages to it." It was funny back then; now it's just the reality we all face.

**Figure 2.1. Budget Shares for Lowest and Highest Initial Wealth Quartiles by Age Band**



# Rediscovering Budgeting

When millions of Americans leave work, they also leave behind the comforts of a paycheck. Suddenly, in retirement, they are exposed to a chore that they last experienced in their 20s and 30s: managing a budget that might feel tight. Chances are it was not a pleasant experience then, and they are not looking forward to it now.

The concept of budgeting has a limiting feel to it with a dash of guilt mixed in. You are supposed to limit your expenditures below a threshold that may be set by outside influences (the press, so-called "experts"), and in extreme cases, you are told that your future financial success depends on giving up coffee in the morning or the now-famous frivolity avocado toast.

In the past, there was the added hassle of tracking where your money went, but today there are a variety of tools that will do this for you, linking to your bank and credit card accounts and putting each expenditure into its proper category. Yes, you have to tweak the categories to customize them, but after that, you have the numbers part of it pretty much tamed.

The most recent approach to budgeting takes some of the guilt and much of the limit out of the process. You might have heard of the 50/30/20 framework which is as simple as it sounds. The first 50% is allocated to your needs, that is, your basic expenditures like food, housing, transportation etc. The next 30% is allocated to "wants," things like dining out, travel, buying gifts. Under this formula, the last 20% is allocated to savings and debt repayment, but of course, retirees are generally not repaying their student loan debts and probably haven't racked up unpaid credit card debt. Nevertheless, that 20% can become a kind of safety net for various unplanned expenditures like car repairs and potential healthcare expenses.

But retirees aren't getting a regular paycheck which means they must calculate how much to apply that budget to. There are a variety of ways to calculate how much sustainable income can be derived from a retirement portfolio, some of them quite sophisticated, and all of them dependent on future assumptions that may or may not come true. One way to start is to tote up all the basic living expenses and lock those down. Take Social Security, pension, or other stable income and allocate that to the "needs" bucket and see how much of the needs are still uncovered. Any excess will need to come from the nest egg.

That's the 50% part of the equation. Three-fifths of that amount, under the structure, would equate to the 30% discretionary spending bucket. This amount is available for spending on, well, anything the retiree wants. Does that size monthly expenditure feel comfortable, based on the total portfolio amount and time frame between now and the end of retirement? Is that a safe paycheck to take out of a portfolio that may be gradually depleted? This is a subjective decision, and of course, some of that 30% will be set aside for larger items like an international vacation; it won't all be spent in the same month. Having a financial planner crunch these numbers for you can help take the subjectivity out of the equation.

There are no hard and fast answers to these questions, but framing it this way might help a retiree get back into the budgeting game with an organized way of making spending decisions. They might be surprised to find that, unlike when they were in their 20s and 30s, budgeting can be uncomplicated and less painful.

# Tax-Smart Charitable Giving

There's a persistent misnomer in the minds of some financial consumers that charitable giving can be profitable to the giver from a tax standpoint if the gifts are carefully structured to avoid capital gains taxes and generate tax write-offs. But in fact, there are no clever strategies which make it profitable to give away money or assets.

However, there are ways to make gifts and donations less expensive on an after-tax basis, which means that people can be more generous to their charity, church, or educational institution by leveraging the tax code a bit. The simplest tax-advantaged giving strategy is to give appreciated stock, real estate, or other assets from a taxable account (not a traditional or Roth IRA) instead of writing a check. This allows the donor to transfer the full value of the assets without ever having to pay capital gains taxes on the amount of appreciation. Their donation can be up to 20% higher than a cash donation and yet come out equally on an after-tax basis.

Donors can also, of course, claim a tax write-off on their charitable contributions. For appreciated assets, this is generally limited to 30% of their adjusted gross income. A more serious write-off obstacle is the high standard deduction, currently $27,700 for married couples filing jointly. If the donation plus other deductions don't exceed that threshold, it makes more sense to simply claim the standard deduction which means there is no tax benefit (or write-off) from the amount given.

The solution? A savvy donor could bunch multiple years of contributions into one year, putting a larger contribution into a donor-advised fund. This pushes the contribution in the current year beyond the standard deduction, recovering the tax write-off by itemizing deductions, and then the donor could make his or her usual annual charitable gifts from the donor-advised fund.

Another tax-aware giving strategy for people who are taking required minimum distributions (RMDs) from their IRAs is to make use of qualified charitable distributions (QCDs). Individuals age 70½ or older can have up to $100,000 per year go directly out of their IRA to a charitable organization, which would satisfy the RMD requirement, and never have to pay taxes on the distribution.

And then, of course, there are a variety of trust vehicles which offer tax advantages. Donating to a charitable lead trust provides income payments to a charity for a fixed term of years, and when the donor dies, whatever is left in the trust will be passed on to the heirs. This can be structured to generate an initial write-off or to eliminate estate taxes on the inheritance.

If the donation is made to a charitable remainder trust, there is an immediate tax write-off, and the trust will provide income to the donor for a fixed period of time or life, and upon death, the remaining assets will go to the charity of the donor's choice. The amount of the write-off is determined by the size of the income the donor receives. Charitable gift annuities work in a similar fashion; there is an up-front tax deduction and a lifetime stream of income payments flowing back to the donor until death at which point the charity takes full possession of the remaining assets.

The simple point here is that the U.S. tax code encourages and even helps leverage charitable activities, even if it doesn't go so far as to make them profitable. Tax-smart donors can give more and have more impact.

Financial Services Advisory
One Church Street | Suite 901
Rockville, Maryland 20850
301.949.7300

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