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FINANCIAL INSIGHTS

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Tax Alert: Plan Now For The Demise Of Stretch IRAs

Say goodbye to the stretch IRA! That's the message from Congress, where a pending bill with bipartisan support would deep-six this tax-advantaged practice. Stretch IRAs have been a boon to non-spouse beneficiaries who inherit a retirement account because they can extend the period of tax-free growth on an inherited IRA over their expected lifetime.

Under current rules, for purposes of illustration, assume a father dies and bequeaths his 40-year-old daughter his individual retirement account. The tax code requires that she takes distributions out of the account every year. But she can extend that to over her actuarially expected lifespan codified in a table published by the IRS.

An heir can expect to live to 95, according to actuarial tables. That means a 40-year-old female heir can avoid taking the money all at once in a lump sum — and won't have to pay the IRS a big chunk of it. Instead, you can withdraw just 1/55th of the IRA amount annually, which obviously is less money than the whole of it, but also has less of a tax bite. Meanwhile, by extending the payout period, the account can grow in value over the decades, giving you more money than the sum you inherited.

Congress, however, is intent on ending this good thing. The legislation, called the Setting Every Community Up for Retirement Enhancement Act, or SECURE, passed the House of Representatives by a whopping 417 to 3. A similar version is pending in the Senate.

The law contains provisions that would be beneficial to many retirees, such as delaying required minimum distributions (RMDs) from your tax-deferred retirement plan or IRA to age 72 instead of 70½. Deferring taxes 18 more months when your account is near its all peak value is a nice boost for you, owing to the law that is widely expected to be passed by the end of 2019.

Under the House bill, a beneficiary must deplete an inherited IRA within 10 years of the owner's death. (Inheriting spouses get the money tax-free and with no RMD.) While the Senate proposal permits a lifetime stretch of the deferral on the first $450,000 of an inherited IRA, the balance is required to be withdrawn in five years. The appeal to lawmakers of squelching the stretch IRA: it would raise $15.7 billion in Government revenue over the decade through 2029.

There are ways, though, to set up an inheritance to replicate a stretch IRA. A parent or other IRA owner, who wants to pass along the money with less tax depletion and more flexibility, would want to weigh the following strategies to

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Watch The Fed Closely In The Months Ahead

In June, the economic expansion entered its eleventh year, officially setting a new record as the longest growth cycle in modern U.S. history. The previous record-setter was the 10-year expansion that bracketed the 1990s.

From The Great Recession of 2008, the worst spate of negative gross domestic product (GDP) since The Great Depression, the current growth cycle began in April 2009, and GDP grew only modestly until 2015, when real wage gains accelerated, and that has propelled stronger than expected growth for the U.S. for over four years. Though U.S. growth recently leveled off, it's been a spectacular expansion by modern standards.

The Federal Reserve was nimble in changing interest rate policy as trade war and as real war fears heightened, and the expansion is poised to continue into 2020, but the Fed's model of the economy has not always been accurate in the past. Far from it! The Fed has caused every recession since 1954 by making a monetary policy mistake and misreading the economy — tightening credit too much and choking growth.

Since this expansion began, the Fed's forecast for inflation has been incorrect. Fritz Meyer, an independent economist whose research we purchase, says the Fed's fear of inflation is overblown. If he's right, the Fed may come around and allow the economy to grow through most of 2020 without raising interest rates. Watch for the Fed to show less fear of inflation in the months ahead.

Give To Charity From An IRA To Lower Your Tax Bill

To keep your tax bill down, if you are over 70½, consider a qualified charitable contribution, which makes donations of up to $100,000 from an Individual Retirement Account (IRA) to a fully deductible charity.

A qualified charitable distribution (QCD) lets you donate from a traditional or inherited IRA, provided you meet the age requirements.

A QCD can help you eliminate, or at least reduce, taxes owed on your required minimum distribution (RMD). That's the amount you are required to take out of your IRA account annually after turning 70½.

Example: Your yearly RMD is $20,000, which counts as taxable income. But if you donate that amount to a charity, it's not counted as income, which may drop you into a lower tax bracket.

Moreover, you don't have to itemize to take this tax deduction. That's good news for Americans no longer itemizing deductions on their returns. To be sure, some taxpayers are hurt by the Tax Cuts and Jobs Act's $10,000 cap on state and local tax deductions, so a qualified charitable distribution can make sense.

You don't have to donate the entire amount to a single charity. You can divvy up a QCD among multiple IRS-eligible charities, within the $100,000 annual limit. You don't have to use 100% of your RMD for the donation, of course, and can keep what you need to pay for your living expenses and donate the rest.

QCDs require careful attention to ensure your donation is made from an individual retirement account — not a 401(k) or 403(b). In addition, you may not make a QCD and also itemize charitable deductions. You must pick one. Plus, the charity must not be a private foundation or a donor-advised fund. These technical details are crucial.

Another QCD tip: Make the contribution straight from your IRA. The RMD money must never be in your personal, non-IRA account. Send your IRA custodian instructions to send the check directly to the charity, with the organization's name on the check. Have the IRA custodian send you documentation that you made the donation.

Finally, be sure to make the donation before you take your RMD. Should you take the RMD first, you can't give the money back to the retirement account and will be ineligible to deduct it.

The QCD is a fairly complex solution to lower taxes and requires the advice of a qualified tax professional. ●

Risk And Tax Effects Of An Installment Sale Of A Home

An installment sale of real estate is a variety of seller financing in which the buyer is borrowing from the seller. Why would a seller want to do this? Isn't it better to get the money up front? No, not always, especially when a sizable real estate capital gain would push you into a higher tax bracket.

An installment plan can give a home-seller a way to unload homes in bad market conditions and enable buyers who otherwise would not qualify for a mortgage to buy a home. Installment financing is a familiar concept for big-ticket consumer items, like cars and furniture, but handily applies to dwellings.

Some of this arrangement tracks the standard housing finance playbook. The buyer makes a down payment and agrees to pay the rest over a set term, which can be whatever the two parties want it to be. And they also set an interest rate on the loan.

What's more, to protect the seller in the event that the buyer defaults on loan payments, the buyer takes out a purchase-money mortgage. This is posted with the local property records agency, which establishes the arrangement in case disputes arise. The seller can foreclose if there's non-payment and take possession of the home. Point is, the seller can be well-protected but full and fair disclosure of the terms must be managed diligently.

In tax terms, the results can be favorable to sellers. Sellers owe no income taxes on the portion of the monthly installment payments considered to be the cost basis—that is, the amount the seller originally paid for the home. The amount of the installment payment above the cost-basis is a capital gain, however, and, depending upon the seller's income, is taxed at a 15% or 20% rate, much lower than ordinary income tax rates. Therein lies the tax advantage. The interest portion of the installment payments is subject to ordinary rates.

In addition to avoid being pushed up

U.S. - China Trade War Coverage Distorts Economic Reality

The amount of coverage in the media of the U.S. - China trade war is far out of proportion with the potential impact that China - U.S. trade has on the U.S. economy.

U.S. exports to China comprise just 1% of U.S. GDP. In the $19-trillion-dollar U.S. economy, the 1% of activity with China is inconsequential. However, Chinese exports to the U.S. comprise 4.1% of China's GDP, which means China has much more at stake.

These facts seemed lost from the recent trade war coverage. Unfortunately, the alternate reality in the media misinforms, misleads and confuses investors. It's no conspiracy or bias, and it spans all political biases. Its journalists trying their best to explain the world. But it is a sign of the times, of a world in which the media's power to reach masses outstrips its understanding of our complex world. Consequently, coverage of the trade war with China was a grotesquely distorted reflection of economic and financial facts. It's no wonder so many investors have trouble adhering to a discipline.

Admittedly, there is much we do not know about the inner workings of the economy. Even Janet Yellen, former chair of the U.S. Federal Reserve Bank, the woman who led the U.S. out of The Great Recession into The Great Expansion, admitted live on CSPAN in September 2017 that the low inflation rate was a mystery to her. And, talk about mysteries, how about productivity? Surging in recent months, productivity caused a totally unexpected U.S. growth spike in the first quarter of 2019 and may be more important to U.S. growth than inflation for the rest of 2019 and 2020. And productivity growth is even more perplexing!

As a result, some people think investing is like gambling at a casino, or betting on a horse, and makes many think investing is not connected with facts. That's just untrue! We do know a few things about the economy that are important to investors:

- Consumers drive 70% of economic growth in America.
- Economic growth drives S&P 500 profits.
- Profits drive stock prices.

Stock prices don't always reflect fundamental economic trends, and past performance never guarantees future results. But economic fundamentals are the key determinant of corporate profits over the long-run, and economic fundamentals remained strong through the recent trade war scare. That's why stocks didn't come undone despite the media frenzy over the trade war with China.

While not everything about the economy is understood, facts matter. It's wise to stay focused on economic fundamentals. If you're investing for the long-run, lest you risk being influenced the media sometimes grotesquely distorted reflection of economic facts. ●

to a higher tax bracket with a big onetime gain from a traditional sale, higher-income sellers skirt the 3.8% net investment income tax. Sellers subject to this additional tax are singles with adjusted gross incomes over $200,000 and married couples with AGIs above $250,000.

This strategy has its downsides in certain circumstances. If you're a seller of a business property and have taken big depreciation deductions on it, then the installment plan might not work. Depreciation recapture rules could trigger a 25% tax on previous write-offs for depreciation. In addition, mortgage lenders must be prepared to deal with late payments from borrowers, which can become complicated and ugly.

True, a house is not always a home, but it can be a tax savings, if everything goes right. ●

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The Demise Of Stretch IRAs

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maximize your impact on the next generation:

Convert the IRA to a Roth. Before an IRA holder passes, it might be wise to convert the account to a Roth. The giver will have to pay taxes on the money up front. But a Roth requires no minimum distributions annually; your heirs will owe the IRS zilch and can withdraw at his or her own schedule.

Insure payment of the conversion tax. One way to pay the Roth conversion taxes is to take out a life insurance policy on the donor — the proceeds from which are tax-free. At the IRA donor's death, the policy's proceeds pay the taxes for the Roth conversion. Otherwise, the up-front taxes may (and often do) come from the IRA itself, thus shrinking it. An insurance product's cost must be considered as well as the creditworthiness of the insurer.

Set up an irrevocable trust with a life insurance policy. This is a variant on the previous strategy. Here, the donor takes a distribution from the IRA long before death and uses the money to fund the trust. The trust is called "irrevocable" because the terms of the trust can't be altered without the approval of its beneficiaries. Although the trust can't grow tax-free, like a stretch IRA, its distribution is also at the discretion of the recipient.

Create a charitable remainder trust. For those of a philanthropic bent, this arrangement serves a double purpose. At death, the IRA owner funds the trust, which pays the beneficiary for a specified period or for the person's lifetime. The trust establishes a set amount or percentage that goes to the inheritor. (The estate receives a charitable deduction for the gift.) The other big win: what's left over goes to a designated charity.

Implementing these tax strategies requires the advice of an experienced tax professional, who understands your personal situation. This article is not tax or legal advice, but it is an alert to IRA owners and their beneficiaries to watch the proposal now wending its way through Congress and prepare to act on a strategy. U.S. tax laws historically are usually not signed until the end of the year but waiting on this tax reform to be signed may not leave you enough time to formulate the best strategy for minimizing taxes owed on an inherited IRA under the SECURE Act and optimizing your impact on the next generation of your family. Please contact us with questions. ●