Subject: Tax and Investment Update

Clients and Friends:

Before we get into the financial topic of the day, we want to express our sincere condolences to the Hollis family for the recent loss of Ron Hollis. Ron started Premier Wealth Management company in St. Charles years ago. Steve Hollis then joined his dad and thereafter Keith and Ashleigh helped Ron and Steve with servicing those clients. Premier is now part of Syntegra and we will miss Ron dearly. He made such an impact on clients and their families for generations. In addition to helping his clients, Ron's charitable work throughout St. Charles, with Habitat for Humanity as well as other philanthropic organizations will be felt for years to come. We will miss you, Ron. May you rest in peace.

We've heard from many of you asking about proposed legislative changes that may affect your financial and tax plans. In general, we are anticipating the potential for higher tax rates for higher income earners. This may affect both ordinary and capital gain income. We are also anticipating the possibility of some changes to how assets are taxed at death – either by death becoming a "realization event" for tax purposes or potentially the elimination of the basis "step up". By no means are any of these proposals a certainty, however, we are aware of the suggested changes and the potential impact on some of you.

For some, we may recommend accelerating income through Roth conversions and gain harvesting to take advantage of the lower current ordinary income and capital gains rates. For others, we may seek to defer income via more advanced income strategies. Many may not be affected directly by new tax legislation so no action would be necessary. As always, these recommendations and decisions are highly personal and depend on your unique situation. As we continue to monitor the potential legislation, we will be in touch once we have a clearer picture of the changes and their impact. We have the ability to sort through the clients that may be affected by legislative action and we would be in direct contact with you should anything come through.

In the meantime, here are a couple of whitepapers on the topic. Also, please find a brief excerpt from TRowe Price, one of the financial firms providing regular input to our portfolio management. We are well aligned with this manner of management.

Below you will find some key insights taken directly from the TRowe Price 6-30-21 Semi-Annual Report:

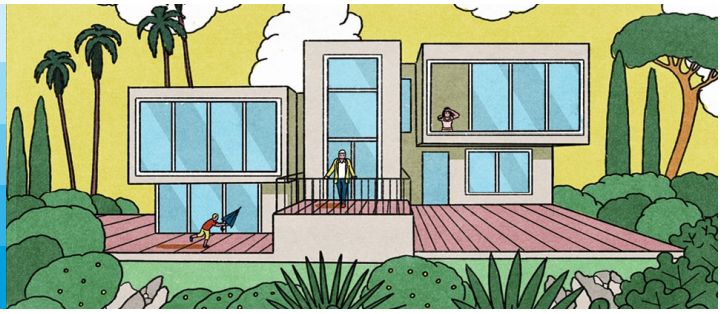
- "The U.S. will likely run north of $6 trillion in deficits in FY20–FY21—$4 trillion more than was previously projected—due to stimulus payments, enhanced unemployment benefits, and payments to businesses impacted by COVID. These deficits are projected to remain elevated over the next couple of years as well. In the very short term, this has resulted in something that has never occurred in the past: a U.S. economy that is likely to be larger in 2021–2022 than it would have been if we had never had the pandemic."
- "It has been a long time since we have seen elevated inflation in this country and this concern is causing people to ask whether it is temporary or something more sustainable. The most likely scenario is that inflation rates will come down in 2022 and 2023."

- “We continue to go where the market gives us fat pitches and are informed by valuation, sentiment, and our five-year forward internal rate of return estimates. Often these fat pitches occur when a company, sector, or a type of investing falls out of favor because it is out of step with the current macroeconomic consensus. This is one of the most powerful inefficiencies in the market and it is an inefficiency that only seems to grow as the market becomes more and more short-term-focused.”
- “Interest rates rose during the first half and this caused losses in traditional fixed income investments. Our fixed income investments rose in value as we hold primarily high-quality high yield and leveraged loans with very low duration, which should do well if rates increase.”
- “These last 18 months have seen a tug of war for market leadership between the most speculative, expensive part of the growth universe on the one hand and deep-value, low-quality companies on the other. Capital Appreciation historically plays in the center of the market in areas such as growth at a reasonable price (GARP), utilities, and other high-quality names that deliver not only strong absolute returns but exceptional risk-adjusted returns.”
- “So, what are we doing to navigate this environment? In a speculative market like this, we are trying to keep up as best as we can but at the same time limit downside risk and protect our shareholders if this speculative excess ends. This means owning stocks that have attractive five-year internal rates of return but also limited downside risk.”

Securities America and its representatives do not provide tax advice; therefore it is important to coordinate with your tax advisor regarding your specific situation.

charles SCHWAB Asset Management

Will Taxes Rise for the Wealthy?



August 20, 2021

The latest major initiative from the White House—a package of social measures known as the American Families Plan, comprising expanded child care assistance, two years of free community college, universal prekindergarten, and more—includes proposed tax increases on the wealthy to help fund the plan.

Among other things, the Biden administration's proposal would:

- Raise the top individual tax rate back to 39.6%—after previously being reduced to 37% by the Tax Cuts and Jobs Act of 2017.
- Tax long-term capital gains and dividend income at ordinary income tax rates for individuals earning more than $1 million annually.
- End the step-up in cost basis at death, which adjusts the cost basis of inherited assets to the fair market value at the time of inheritance when calculating capital gains taxes.

The plan also includes $80 billion for the IRS to help improve the tax-collecting process. (According to the Treasury Department, every dollar spent on tax enforcement by the IRS generates about $6 in revenue.) Such efforts are likely to affect the top 5% of taxpayers, including business owners, corporations, and the wealthy.

Of course, the president's proposal is just that—a proposal. It will take an act of Congress to turn the White House's proposed American Families Plan into legislation—and there's a good chance that what emerges, if anything, will look very different from what the White House has initially outlined. That said, our view is:

- The increase in the top individual tax rate has the broadest support among Democrats—and therefore the best chance of being approved.
- Changes to the capital gains tax rate and basis step-up rule, which are not yet universally embraced by all Democrats on Capitol Hill, will be subject to considerable intraparty negotiations.

Importantly, we believe it's unlikely that any tax increases passed in 2021 will be retroactive to the beginning of the year—meaning taxpayers will likely have time to consider what, if any, strategies are appropriate for their situation prior to any new rules going into effect.

Planning for transactions that could result in large capital gains, in particular, could become more important than ever for wealthier households. While we generally recommend a wait-and-see attitude, here are two ways those concerned about possible changes could potentially mitigate their impact should this become law:

1. **Tax-gain harvesting:** Investors often focus on selling losing investments and hanging on to winning ones. However, from a tax-planning perspective, it might be preferable to sell a winner now to lock in a lower tax rate. Realizing at least a portion of your capital gains before any new laws go into effect could help you avoid a higher tax bill and create an opportunity to rebalance your portfolio back to its target allocation.

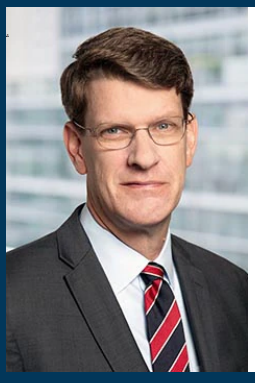
2. **Tax-loss harvesting:** Investors can realize a loss on one investment to offset a gain on another. Should current capital gains tax rates rise for individuals earning more than $1 million annually, recognized losses could bring your net income to just below the $1 million mark—so long as you don't run afoul of the IRS' wash-sale rule, which disallows the loss if you purchase the same or a "substantially identical" security within 30 days before or after the sale date.

Because the changes to inherited assets seem far less certain, it's probably too soon to make any major adjustments to your estate plan. Even so, if you're concerned about what the potential changes could mean for your estate, your financial planner or estate-planning attorney can help you think through your options.

The bottom line

Taxes affect almost every aspect of investing and planning, but they shouldn't take priority over your broader goals and risk tolerance. Before implementing any tax-planning strategies, we recommend meeting with professionals who can help you thoroughly analyze your particular situation.

About the authors



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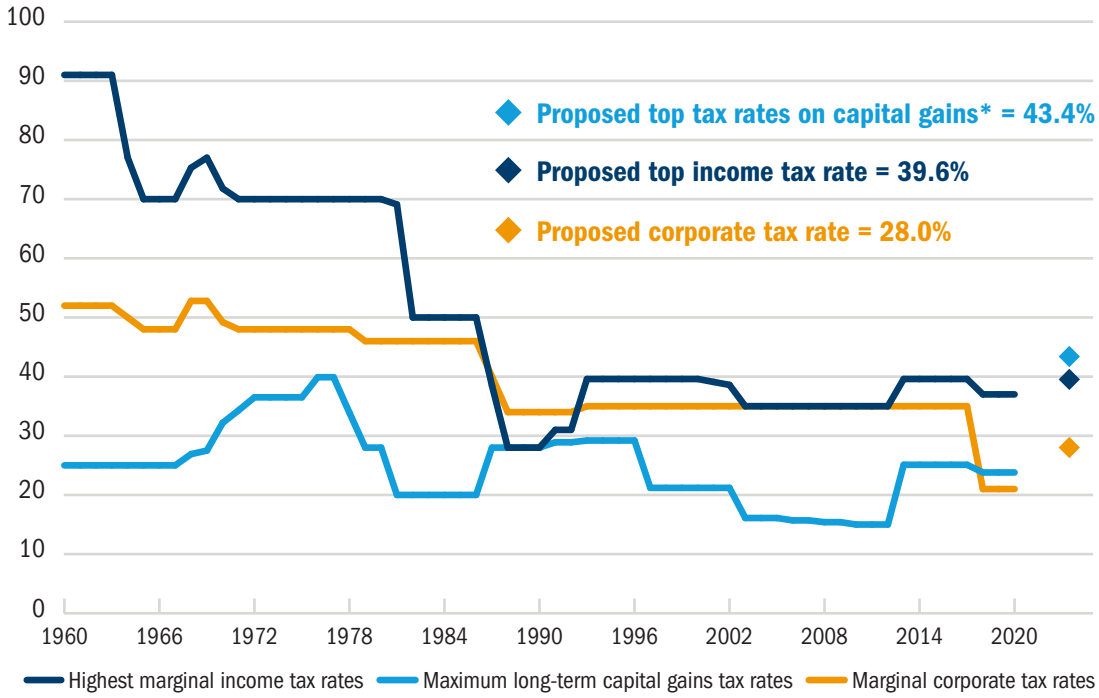
Investors should plan for tax rates to change over time

Historical tax rates (%)



Source: Tax Policy Center

*The proposed capital gains tax is levied for households earning more than $1 million per year and includes the 3.8% net investment income tax.

The Biden administration has recently made proposals for higher maximum income tax and corporate tax rates, although they're still relatively low from a historical perspective. The proposed capital gains rate would be a new high, but it would apply to a limited universe of high-income taxpayers.*

Tax rates haven't stayed constant over time. Over the last 60 years:

- The capital gains tax rate has changed 18 times — reduced eight times and increased 10 times.**
- The income tax rate has changed 16 times — reduced 11 times and increased five times.
- The corporate tax rate has changed 10 times — reduced eight times and increased two times.

While there's still a lot of uncertainty, it's important for advisors and their clients to start the discussion so investors understand how tax changes could impact their investment goals.

* The proposed capital gains tax would be levied for households earning more than $1 million per year.

** The Jobs and Growth Tax Relief Reconciliation Act of 2003 included the way capital gains were taxed and resulted in several years where rates changed. In the text this was counted as one rate change. Past performance does not guarantee future results.

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