ADK Wealthcare Partners

Winter 2020 Cogitations

from Al Kaufman

Winter 2020 — 12/31/2020

SEGMENTS

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"I apologize for the inequities in the practical applications of the tax, but if we should wait before collecting a tax to adjust the taxes upon each man in exact proportion with every other, we shall never collect any tax at all."

— Abraham Lincoln in an 1864 address to the 164th Ohio Regiment

Key Points

1. **The direction of federal income and estate taxes will be murky at least until the Georgia Senate elections are finalized, but the political policy bias of the Biden Administration, coupled with a gapping federal deficit, point to near-to-intermediate term increases in personal taxes (particularly to those deemed affluent), a broadened base for estate taxes, reductions in selective tax breaks for individuals and businesses, and modifications in retirement savings and distribution mechanisms to encourage higher nest eggs for retirees and more distribution latitude.**
2. **While there is debate on how these changes may impact various socioeconomic classes, the maze of tax law and reporting is apt to become more complex for everyone. We'll help you stay tuned.**
3. **Living in a fast-paced culture with many demands on our time, it is easy to get lost in the minutiae of the moment and postpone higher priority endeavors. Perhaps, during a quiet moment, the future looks somewhat daunting. If so, a priority revamp may help. Along those lines, Solomon offers some timely wisdom from a group of social insects. From there, we transition into how ADK oversight and dynamic guidance systems are managed around your specs to improve the odds of successful lifestyle-related outcomes.**

TAX Matters

Abraham Lincoln, as the sixteenth President of the United States, introduced the first federal income taxes in 1862 to help pay for the North's Civil War expenses. His creation of the Bureau of Internal Revenue was the predecessor of the Internal Revenue Service. Within this system, the first $600 of income was exempt from taxes, and beyond that the maximum marginal tax rate topped out at 5%. Tax burdens were designed to fall most heavily on the well-to-do. Federal taxation was envisioned as being temporary, but became permanent with the ratification of the Sixteenth Amendment to the US constitution in 1913.[1]

Fast forward a few generations and we see an expanded version of what began as a temporary funding solution to a temporary need. National election outcomes and tax law changes now go hand-in-hand, but the degree of change to existing code in 2021 will hinge largely on the outcome of the Senate elections in Georgia and the impact it has determining the Senate Majority.

Early in the Biden administration, several items have a decent shot of being realized: [2]

- Additional stimulus measures.
- Retirement savings and tax incentives for IRA owners and 401(k) participants.
- A package of temporary tax extenders scheduled to expire at the end of 2020.
- Tax breaks to encourage firms to produce critical products in the US.

As things stand, the Biden tax plan projects potentially significant tax increases to those deemed affluent—incomes over $400,000. How that figure is derived for tax purposes is unclear. Capital gains taxes may also revert to ordinary tax rates as certain income levels are realized. Republicans will put pressure on Biden to make the 2017 tax law permanent. The give-and-take of competing philosophies is apt to introduce more confusion and complexity into the tax code, but there are often opportunities in this type of environment.

Even if corporate and marginal tax rates do not vary by much when the legislative dust settles, new taxation thresholds and special calculations are likely to lead to higher taxes for corporations and affluent households. After all, the US federal government deficit continues to grow exponentially and we are in the season of legislative micromanagement where the only predictable fruits of Congress' first order of business is to foment the predictable, yet informal, "Tax Accountant and Legal Advisory Full Employment Act." Thousands of pages of new tax-related legislation are good fodder for developing conceptual underpinnings and unearthing loopholes. The new economic relief law exceeded 5,000 pages, so Congress may just be warming up.[3] Soon-to-be President-Elect Biden is also contemplating a third stimulus bill. (*Looking for ways to go long on legislative parchment. Animal skins are out these days, but fir trees and other plant-based fibers may be worth a look!)*

Estate Taxes

Federal estate taxes are also being discussed and exemptions ($11.7 million in 2021 for individuals; combined exemption of $23.4 million for married couples[4]) could be scaled back even before their scheduled sunset at the end of 2025—where the individual exemption would be roughly $5.85 million today if left alone. Federal estate tax rates can reach 40% currently and according to Kiplinger, there are also eighteen states with *scary* death taxes.[5] While

less than 1% of estates currently face estate taxes at the federal level, that figure could easily change in today's political environment. (As a very crude comparative benchmark, about 4 ½% of the estates pay taxes in the UK.[6])

> Fiscal pressures are likely to prompt changes in the comparatively favorable estate taxation environment that now exists. Gifting, family business transitions, and other wealth transfer mechanisms should be considered sooner than later, within the context of an updated estate plan, before more favorable financial avenues begin to close.
>
> ADK

Apart from reducing tax exposure and nurturing legacies, an estate plan is also valid and constructive for addressing other maladies of life, such as incapacity. Your customized lifestyle plan includes net worth detail, projections, and other household information useful to an estate planning attorney. Additional detail and insights can also be provided by our firm. If you have not reviewed, or updated your household will(s), trust(s) and other legal documents in a while, please consider doing so in 2021. As we have all seen in 2020, life contingencies can be forced upon us unexpectedly.

Selective IRS Pronouncements for 2021

401(k) Plans [7]

- Deferral limits for 401(k) plans: $19,500
  - + Catch-up contribution 6,500 (for those age 50 and over)
- Overall limit on contributions to all of your accounts maintained by one employer are limited to the lesser of: 1) 100% of participant's compensation, or 2) $58,000 **($64,500 with catch-up contributions**)

IRA Contribution Limits for 2021 [8]

- Total contributions you can make to traditional IRAs and Roth IRAs can't be more than:
  - $6,000 (**$7,000 if you're age 50 or older**), or taxable compensation if less
    - Spouse can contribute same amount if filing jointly, even if they did not have taxable compensation

Annual Gift Exclusion for 2021

- **$15,000**

Trending Legislation

As taken from legislation that is being developed, such as Secure Act 2.0:

- Individuals 60 and above could have more flexibility to set aside savings as they approach retirement.
- RMD ages could be increased to 75.
- Individuals seeking qualified charitable deductions (QCD) through their IRAs, may be able to contribute $130,000 +/-.
  - 401(k) could also receive similar QCD treatment.
- Deductions for retirement savings may be reduced or eliminated in favor of a standardized crediting system (perhaps 26% or so)—designed to be more beneficial to the less affluent—as defined by policymakers.

Other legislative tracks: [9]

- New top tax rate.
- Possible repeal of the qualified business income deduction for "high-income" earners.
- Potential 28% cap on the value of itemized deductions.
- Prospective 50% decrease in the Federal estate

and gift tax exemption to $5.79M.

- Elimination of step-up in basis and new 'deemed -sale-at-death' rules that could concentrate capital gains into top ordinary income tax brackets. (Decedent's estate would essentially realize gains and losses at date of death.)
- Smaller firms may be granted a larger credit for establishing a retirement plan.

RMDs in 2021? 'They're Back'

In late 2019 the Secure Act increased the age at which people must take required minimum distributions from 70½ to 72. Those who turned 70½ in 2020 did not have an RMD requirement.

Due to the Cares Act, which originated during the pandemic, most people were allowed to skip RMDs in 2020 altogether. However, the exemption on RMDs hasn't been extended, so those who are 72 or older in 2021 should plan to take them by year-end 2021—to avoid the 50% penalty.

You will be contacted soon to arrange for a time to discuss specific strategies, tactics, legislative updates, and recommendations in mid-to-late January.

Please don't hesitate to call or email if you have any questions in the meantime.

Lifestyle Barometers

Go to the ant, you sluggard! Consider her ways and be wise,

Which having no captain, Overseer or ruler,

Provides her supplies in the summer, And gathers her food in the harvest.

How long will you slumber O sluggard? When will you rise from your sleep?

A little sleep, a little slumber, A little folding of the hands to sleep —

So shall your poverty come on you like a prowler,

And your need like an armed man.

— PROVERBS 6: 6 - 11

Solomon often used nature to illustrate wisdom, and didn't 'beat around the bush' when making a point. Ants have small brains, but know enough to prepare for leaner times. Working and planning are an important part of their daily lives.

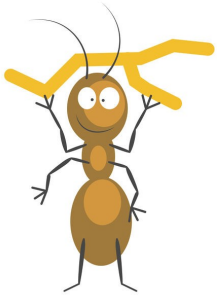
Ants have other interesting behavior patterns. According to a study at the Institute of Science and Technology Austria and the University of Lausanne, ants protect their colony from an outbreak of disease. Apparently, ants can detect fungal diseases brought by older ant workers who are foraging. Once they detect the pathogen, ants will adjust their behavior and organization to protect the most valuable individuals within their colony: the queen, brood, and young workers from becoming ill. The foragers then hang out with other foragers for a time until the risk of spreading the disease to the entire colony has passed.[10]

These collective adjustments and sacrifices are interesting in light of an ant's caste-dependent lifespan. Males live for a few weeks, Workers usually live for a few months, and Queens can live for decades under the right conditions.[11]

The size and capacity differences between an ant brain and human brain are very significant of course (250,000 neurons to about 100 billion), but they have fewer blinking lights and advertisements to contend with. Consequently, they can still accomplish quite a bit in their relatively short lives by being focused on tasks most pertinent to their existence. We can learn from their resource management practices.

These wise ants don't just work and plan, they adjust as needed to preserve what is important to them during their station in life and beyond. Perhaps they can even teach us lessons about quarantining with Covid. **Long live the Queen!**

Foundational Underpinnings



Humans don't have much in common with ants at first glance, but if Solomon offers their activities as a lifestyle example, there is something to learn. Some of the insights that could be gleaned from the previous section, allowing for some artistic license, are offered below under 'Ant Insights.' Using those building blocks, practice oversight biases and guidance systems will be examined and explained in greater detail such that you may have a better appreciation of what we're doing on your behalf and why—within the realm of ADK Wealthcare Partners, an Independent RIA.

'ANT INSIGHTS' from ADK

on Pre-Retirement Endeavors:

- **Work**
- **Save**
- **Plan**
- **Adjust**
- **Chill when needed**
- **Endure and enjoy the ride**
- **Have fun along the way**

on Retirement:

- **Stay active**
- **Stay connected**
- **Live within means**
- **Enjoy your days**
- **Be content with your station in life**
- **Don't be afraid**

If "A journey of a thousand miles begins within with a single step," is true, there's a good chance that a successful journey is first prompted by a purposeful vision. In our service environment, that vision starts with you and your household priorities.

Around ten years ago, Warren Buffet and Bill Gates called upon their fellow billionaires to pledge half of their wealth to charitable causes, either in their lifetimes or after their deaths. Doing so would still leave a pretty good chunk to live on, but they were probably diligent with their planning efforts such that they could still live the lifestyles they enjoyed, and still influence family endeavors if that was their preference.

At the same time, Michael Bloomberg endorsed the 'Giving Pledge' in principle but gave an extra nod to one of his biases, . ." that the best financial planning ends with bouncing the check to the undertaker."

Mr. Bloomberg's plan would probably be more difficult to develop and monitor if taken literally, but probably attainable with a dynamic financial guidance system and combination of gifting techniques, business control changes, forward-looking and creatively written trusts, bright estate planning attorneys, cooperative family members, and either an understanding undertaker who held no grudges, or one who delayed check deposits.

Of course, previously wealthy people have also died relatively poor, or gone bankrupt. Judy Garland, Gary Coleman, Bela Lugosi (of Dracula fame), Johnny Unitas (The Golden Arm), and Evander Holyfield are among the famous whose finances did not pan out well. Family turmoil, substance abuse, and failure to pay back taxes were contributing factors in several of these instances.

These illustrations reflect what we already know: having a certain amount of wealth does not mean things will turn out well. Taking outsized risks, incurring exceptionally high debt loads, moral failures, living be-

yond our means for a prolonged period of time, and health decline are among the potential perils that can bring anyone down.

However, adhering to some of the basics associated with traditional financial planning can be a huge help in determining current status, where things are trending, when adjustments may be warranted, how much risk to absorb, and when outside help is needed, or perhaps becomes mandatory.

Day-to-day and short-term stock market ups and downs are not barometers for how your resources are positioned to meet current and future needs. Making emotional decisions on the basis of how the market performed that day, or what someone attributed the market movement to, can be harmful to wealth creation.

Market commentators on television, as bright and charismatic as many are, are generally not compensated to help households reach their objectives over the long term. Entertainment is more of a driving factor. In my opinion, if eyes are glued to financial market news venues for too long—even for general entertainment—emotional biases can form which are probably hazardous to good judgment and sound investment disciplines.

Consider the benefits of a more holistic barometer when assessing current and future status.

<u>Wealth Trend Barometer Considerations</u>

If a household will help to identify their:

1. spending preferences through retirement with regard to needs, wants and wishes,
2. legacy preferences,
3. various sources of non-investment cash inflows they expect to receive—such us pension, or payout options,
4. potential for receiving significant inflows in the future—such as inheritances, business and property sales,
5. anticipated, or desired, outflows for larger purchases,
6. balance sheet composition,
7. preferences and timing for balance sheet modifications—such as debt reduction,
8. household lifestyle preferences,
9. preferred risk range for investments,
10. preferred retirement inception,
11. desire and timing for assisting family,
12. desire and timing for helping others,
13. preferences to lessen lifestyle risks,
14. desire to understand financial tradeoffs involving various risk reduction strategies, . . . *and could then*

    - understand the feasibility of these various life event combinations over one thousand realistic, hypothetical lifetimes,
    - using realistic market return modeling,
    - adjusted for taxes,
    - adjusted for inflation,
    - to determine if a particular resource grouping is feasible or favorable,
    - and view the output of these realistic outcomes as depicted in a single metric,
    - at their convenience on a secured site,
    - with dynamic updates in seconds,

might that be a helpful barometer?

I hope you said yes.

If not, I probably did not explain it very well.

At a firm whose primary job is to protect our clients' lifestyles, a yardstick of this nature is one of the most important measurements we have to determine whether clients are on the right track relative to their unique resources, objectives, priorities, and expectations.

This powerful 'barometer' metric is called a ***Comfort Zone Score*** and created through the powerful financial planning software we utilize—which was

named the top choice of financial planning software for eight straight years according to *Financial Planning* Magazine's annual survey.

The 'Comfort Zone Score' reflects the number of instances that a realistic lifetime scenario resulted in a favorable ending out of 1,000 separate and independent trials. So if markets get cranky, rather than focus on day-to-day changes in account value, you have a wonderful barometer from which to evaluate the impact on your entire plan—as the value of your investments at Schwab are dynamically linked to your lifestyle plan.

You will soon receive instructions for electronic access to a secure site, so you can review your plan, and scoring, at any time.

We can discuss this and other features of the program when we meet to review your current plan in the weeks to come. In the interim, several illustrative questions are presented in the next section to help reinforce where feedback is offered in 'Baseline 2020' — your recently updated plan.

ILLUSTRATIONS

- We've worked for decades. How do we know if we're on the right track prior to, and throughout, the rest of our lives?

Comfort Zone Score

We evaluate 1,000 [realistic] lifetime trials of your plan using randomized return possibilities to calculate the probability your plan will be successful. Subject to the inputs we discussed and reviewed, you're on a solid path with a score above 80. Please also reference 500th trial detail (last section of report) for a look at cash flow sequencing.

- Where can I view the plan's spending recommendation and comparison to goals?

Plan Summary section

- What is my current net worth and where can that detail be found?

Net Worth summary and detail section

- Where are my cash flows coming from and when?

Total Income Analysis section

- I am concerned about a potential health setback. What can I do to protect my family from an economic collapse should my health fail me?

Special scenarios can be tested and evaluated with recommendations for change.

- It seems like financial markets, with their periodic downdrafts, are not suited to deliver reliable income at times when I may need it the most.

We agree with that concern and work to match secure income sources with anticipated needs to the highest degree practical. We also incorporate your entire balance sheet into our decision making. Please reference <u>Secure Income Analysis section.</u>

- How does my current portfolio compare with the plan's target allocation given my/our desired risk levels? And how does that compare to other individuals our age?

<u>Risk Assessment section</u>

- How do your recommendations compare to the spending and saving goals we had hoped for?

<u>Results—Current and Recommended section</u>

- What are the implications if my wife and I take social security at different ages?

<u>Worksheet Detail — Social security analysis</u>

- I'm detail oriented. Where can I see the year-to-year cash flows for one of my life span scenarios?

<u>Worksheet Detail — 500th Trial</u>

- Can I view my current plan and recent report online in a secured setting?

Yes. We can also view the plan together in a secure online session if you like.

Draft plans **have a basic image on the cover**

page. Once plan updates have been developed with client confirmation such as Baseline.2020, the cover page will reflect retro glasses.

Endnotes

1. Some Presidential Words on Federal Income Taxes, https://www.forbes.com/sites/peterjreilly/2012/08/15/some-presidential-words-on-federal-income-taxes/?sh=157077007ee7, August 15, 2012

2. The Kiplinger Tax Letter, Nov 13, 2020, pg 1

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5. https://www.kiplinger.com/retirement/inheritance/601551/states-with-scary-death-taxes, December 2, 2020

6. https://www.moneyadviceservice.org.uk/en/articles/a-guide-to-inheritance-tax,

7. Retirement Topics, https://www.irs.gov/retirement-plans/plan-participant-employee/retirement-topics-401k-and-profit-sharing-plan-contribution-limits

8. Retirement Topics, https://www.irs.gov/retirement-plans/plan-participant-employee/retirement-topics-ira-contribution-limits

9. From Live Webinar notes, Michel Kitces Demystifies the Biden Tax Plan, December 17, 2020

10. https://www.resteasypestcontrol.com/ant-brain-vs-human-brain-what-humans-can-learn-from-ants/

11. https://www.terminix.com/pest-control/ants/life-cycle/

12. The Atlantic, https://www.theatlantic.com/business/archive/2010/06/buffett-and-gates-billionaires-give-away-half-your-money/345144/, June 10, 2010

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15. https://www.g2.com/products/moneyguidepro/reviews

We have many tools and resources to help you throughout your life journey. And to help you help others. Please let us know how we may better serve you. Thank you for your trust and support.

Al Kaufman

Now godliness with contentment is great gain. For we brought nothing into this world, and it is certain that we can carry nothing out. . .

For the love of money is a root of all kinds of evil, for which some have strayed from the faith in their greediness.

—I TIMOTHY 6:6, 7 and 10

Disclosures

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