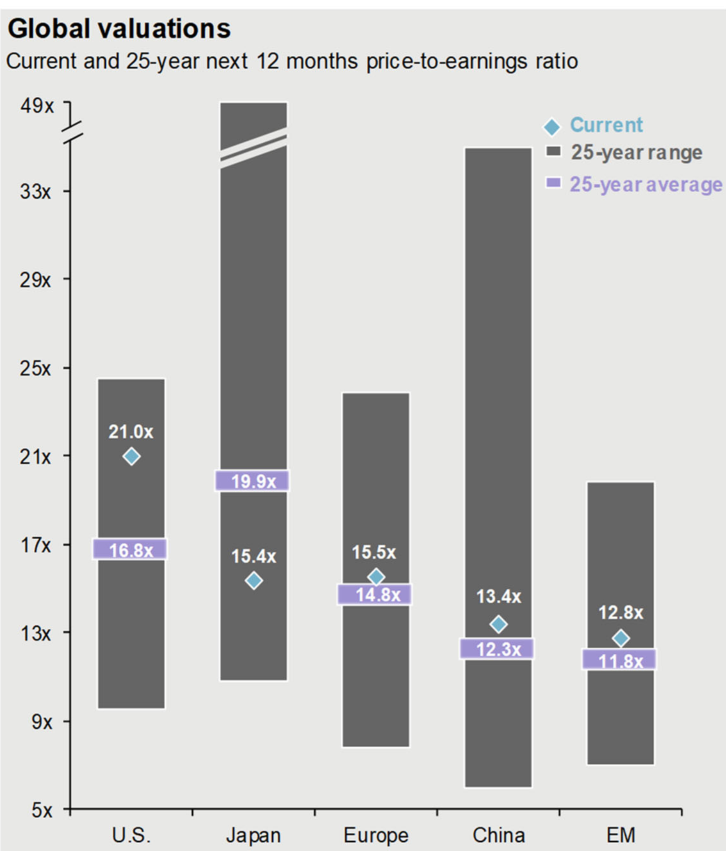
Hillegas Advisory Services
FAMILY WEALTH MANAGEMENT

**Fall 2021**

*28 Years of Service (1993—2021)*

Despite the ongoing pandemic and the emergence of the delta variant, U.S. markets have remained resilient posting solid gains as shown on your personal portfolio reports. Entering the fall of 2021, the economy is continuing to rebound from the pandemic recession. However, the road to recovery has been bumpier than expected recently, with the delta variant hurting travel and entertainment industries while continued supply chain shortages are disrupting manufacturing, resulting in higher inflation. Thankfully, there are now signs that the latest wave of the pandemic is beginning to ebb. If this continues, then the economy should reaccelerate, helped by pent-up consumer demand and the continued impact of fiscal stimulus.

While U.S. stocks are relatively expensive, equity valuations remain attractive in both Emerging Market and Developed Country stocks outside the United States selling at some of their cheapest levels relative to their U.S. counterparts in the last 20 years.




## Taxing Matters Summary

- Single taxpayers with taxable income less than $400,000 and married filing jointly (MFJ) taxpayers with taxable income less than $450,000 should not see much change in the taxes they pay as a result of the changes under the new Biden tax plan.
- Some taxpayers with income below $400,000 and $450,000 could see tax reductions due to the return of the state and local tax deduction.
- If your income is above this $400,000 and $450,000, expect your taxes to go up.
- Top marginal tax rates may go back to 39.6%.
- Capital gains tax rates may increase to 25% beginning at $450k MFJ instead of currently being 20% starting at $501k MFJ.
- Corporate taxes rates instead of being a flat 21% would be 18% on income less than $400k, 21% on income of up to $5M and 26.5% for income over $5M
- Estate tax exemptions could fall to $5,800,000 from $11,700,000.

## U.S. Stocks Expensive vs. International

International equities also offer greater sensitivity to the powerful post-pandemic economic rebound, particularly in Europe and Japan where cyclical sectors make up 53% and 55% of their respective equity markets. This, along with structural growth opportunities and the prospect of a lower dollar in the long run all argue for a greater allocation to international equities. Looking forward to 2022 and beyond, the global economy should finally see a synchronized boom as the pandemic retreats.

## The Worst Tax?!

Think back to how much you paid for your first car or home …and remember when first class stamps cost just ten cents? Here are some highlights on the stealth tax from which no one can escape, inflation. Inflation is perhaps the worst tax as it erodes everyone’s purchasing power and disproportionately harms those at the bottom of the economic ladder. This past year inflation has spiked, with higher prices for economic necessities like food, clothing, housing and energy, with gas up 42% from just a year ago and now over $5/gallon in California. On the flip side, retirees will find some relief with a 5.9% increase in their Social Security Benefits, the biggest increase in 40 years. The balance of this newsletter shifts to taxes as we expect a few changes will be forthcoming in 2022.

## Tax Increases: Most Will Not Be Affected

More detailed proposed tax changes have been released from the Biden tax plan. Will they affect you? Are you concerned about your taxes going up? Before These statements are general in nature; for advice pertinent to your specific situation, you should consult with your accountant.

If you are married and filing jointly ("MFJ") with taxable income of under $450,000 or if you are single ("S") with a taxable income under $400,000, you can relax as you will not likely be affected at all.

In fact, you may benefit from some of the proposed changes such as the return of the state and local tax deduction or a proposed increase in the 401(k) makeup contributions for those over age 50 from $6,500 to $10,000.

For those of you with income above $400,000 S and $450,000 MFJ the rest of this newsletter will be particularly relevant.

***"In this world nothing can be said to be certain, except death and taxes"***
***– Benjamin Franklin***

## Some Proposed Changes

If your taxable income is above $400,000 S and $450,000 MFJ, expect your taxes to go up. But again, we could see a partial return of the state and local tax (SALT) deduction that would help offset this increase depending how much over the $400,000 and $450,000 thresholds your income is, combined with how much state income tax and property tax you pay.

Repealing the $10,000 cap on SALT deductions would primarily benefit high-earning taxpayers in high tax states like California, New York, New Jersey and Connecticut. In 2022, repealing the SALT cap under current law would provide a 2.8% increase in after-tax income for the top 1 percent of taxpayers and a 1.2% increase for the next 4 percent of highest-earning tax payers.

Below are some of the basic proposed changes:

- Top marginal tax rate increased from 37% to 39.6% beginning at $400k S and $450k MFJ. (effective 2022).
- Capital gains tax rates increased from 20% to 25% beginning at $450k MFJ (effective now).
- Net Investment Income Tax (NIIT): S Corporation profits would no longer be free from employment taxes and NIIT, a 3.8% tax would be imposed on all pass-through business earnings either through the Medicare tax or through NIIT (effective 2022).


- Total income, including capital gains and business income over $5M and $100,000 for trusts would be subject to a new 3% surcharge (effective 2022).
- Corporate taxes rates, instead of being a flat 21%, would be 18% on income less than $400k, 21% on income of up to $5M and 26.5% for income over $5M (effective 2022).
- Non-publicly traded private placement investments in IRA accounts would be eliminated (effective 2022 with two years to remove from existing IRAs).
- Roth conversions would no longer be available for clients with income over $400k S, $450K MFJ (effective 2031). Plan for conversions over 10 years if in a 25% tax bracket or lower.
- After tax 401(k) contributions and conversions will no longer be available (effective 2022). You need to make sure your companies are converting before the end of the year.
- The estate tax lifetime exemption currently at $11,700,000 per person will be reduced to $5,800,000. The reduction for real estate used in a family business will be increased to $11,700,000 (effective 2022).
- Valuation discounts for non-business assets such as investment assets in family limited partnerships will be eliminated (effective with transfers of gifts after enactment).
- Grantor trusts such as SLATs, IDGTs and basically any trust in which the income passes to the grantor would be included in the estate for estate tax purposes. This is effective for new trusts signed after enactment and with new gifts or funds transferred after enactment.

## A Few Thoughts and Ideas

For those with income above $400k S and $450k MFJ the two primary changes will be higher capital gains taxes and the 39.6% tax on income above these thresholds. If you are in this situation and it looks like your income will stay at this level all the way through your retirement years, you may want to consider a Roth conversion this year because you would pay a reduced 37% tax rate on monies converted.

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Another way to increase income - at the lower 2021 rates - would be to postpone business investment expenses until 2022 when the write off can be taken while you are in a higher tax bracket. This would create more income in 2021 while you still have reduced rates.

As tax rates increase, tax efficient investing becomes even more important. We will continue to focus on low cost, tax-managed investments that generate tax efficient growth. We will also continue to proactively harvest losses through tax swaps during market corrections; this approach results in losses reducing taxes by offsetting current or future capital gains.

## Should you Make Family Gifts Now?

Giving large amounts to family members is a very complicated and personal question - what is right for one family may be wrong for another. That stated, we'd like to share some general thoughts on the matter. If you are single, have a $5,000,000 estate, and are living comfortably within your means, you are unlikely to have an estate tax problem because if the new estate tax lifetime exemption becomes law, you will be able to pass your estate on to your heirs estate tax free. You can also give up to $15,000 per person each year. So, you do not need to consider family gifts to reduce the size of your estate.

The same goes for a married couple except the amounts would double - they could pass an estate of up to $11,600,000 estate tax free, and gift a combined $30,000 each year to any person.

But now let's consider a married couple with an estate valued at $23,400,000 with the following circumstances: 1. they are in their mid-80's, 2. they can easily maintain their lifestyle with an estate of $10,000,000, they have two financially responsible adult children and many grandkids.

If this couple died today with the current estate tax law, they would pass their estate onto their children and pay zero estate tax because they each have a $11,700,000 exemption. If they die after the proposed law takes effect and the exemption is reduced to $5,800,000, their heirs will have an estate tax of roughly $4,720,000 to pay.

To reduce this $4,720,000 tax, one of the spouses could give the kids $11,700,000 and use up their entire $11,700,000 exemption before it drops to $5,800,000. The other spouse would still have the lower $5,800,000 exemption amount, and if they both died the year after doing this planning, they would have reduced their estate tax by roughly $2,360,000.

The top estate tax rate is 40%. If the taxable portion of one's estate is less than $1,000,000, the rate would be less than 40% but just thinking of the estate tax as being 40% will give you a very close approximation of what it will be. For example, with a taxable estate of $2,000,000, ($2M x 40% = $800,000) you would pay about $800,000 in estate taxes. So, if you are able to use up to $5,900,000 of estate tax exemption before it drops to $5,800,000, you basically would save $2,360,000 in estate taxes. In most cases sizeable gifts are made to irrevocable trusts with children and grandchildren as beneficiaries.

If a married couple had an estate worth $40,000,000 and they could easily live on $15,000,000, they may want to gift their family $23,400,000 and potentially save $4,720,000 in estate taxes. On the other hand, they may not want to give up control of their estate. They may feel like their kids are going to get enough money regardless, or they may have other charitable desires that will help them minimize any future estate tax since monies that pass to charities are fully deductible for estate tax purposes.

There is no one-size-fits-all answer here. What is most important is understanding the key variables, and then to making value-based, prudent choices in the best interest of all parties involved.

There is still time to make gifts to take advantage of the higher existing estate exemptions, but you'll need to move quickly because the estate planning legal work will need to be done before year-end should the current tax proposal become law.



***Source: https://taxfoundation.org/salt-deduction-cap-repeal/***

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