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Resolute Connections

Over the past few months several large pieces of legislation have been proposed by different factions of Congress, and may become law later this year. *Tax Proposal Consequences takes* a look at the implications these spending bills will have on taxes. *Inflation and Social Security* tackles proposals to change Social Security's measure of inflation, or the Cost-of-Living-Increases recipients receive each year.

Protecting Elder Americans concerns an ever-increasing problem, elder financial abuse which cost elderly Americans an estimated $36 billion last year alone. And *State GDP Equivalents* is an interesting comparison of each state's economy to a similar foreign countries' economy. California's economy is the equivalent of the UK, while the Texas economy is as large as that of Canada's. NH, well we have some work to do, our closest comparison is Nepal.

If you have any questions about anything we have covered in the articles, or a specific situation please feel free to give us a call, or visit our website, www.ResoluteFinancial.com.

Tax Proposal Consequences

Despite the alarmist articles you might be reading in the press, most people won't be affected very much, if at all, from the tax proposals that are percolating through Congress. How the proposals may affect the overall economy, however, may be a different question. If the bills pass in their current form, then individuals who make less than $400,000 a year won't see any increase in their ordinary income or capital

gains rates, and husband and wife taxpayers with less than $7 million—or maybe $10 million—in net worth still won't have to worry about paying federal estate taxes. However, President Biden has committed to let the 2017 tax changes expire in 2025 to help pay for some of the spending, which will impose tax increases on much of the middle class – but that is four years away and doesn't count as a tax increase - just a reversion to a previous, higher tax policy.

But the proposals are creating some challenges for certain taxpayers, which would have to be planned for. Individuals who are earning more than $452,700 a year, and joint filers reporting more than $509,300, are looking at a top marginal tax rate of 39.6% on income above that amount—up from today's 37%. For them, it makes sense to shift income, if they can, from 2022 into the 2021 tax year.

People who are selling a business, or selling a home or investment real estate with a lot of appreciation, could be facing an even bigger challenge. For taxpayers who report $1 million in adjusted gross income in any given year, the Biden proposal would raise the tax rate on capital gains—that is, on appreciation at sale above the purchase price—from today's 20% to the ordinary income rate, which would be 39.6% plus a net investment income surtax of 3.8%. this may be the first time in US history when capital gains rates will exceed ordinary income rates. As a result, in some states such as California and New York, the total tax rate will be over 50%. That may accelerate the flight to low tax states such as Texas and Florida, and discourage the creation of new businesses. A thinking person might ask why would an entrepreneur work 80 plus hours per week for years in the hopes of taking the company he or she created public, and earning a return on all that effort, if the government will take the majority of profits?

Who else might report $1 million in adjusted gross income? Small business owners who are planning to sell their firms might experience a one-time event where they pop up over that threshold—and find themselves paying more than double the amount they expected to Uncle Sam on the transaction. Similarly, anyone who has a highly-appreciated real estate investment might breach that threshold, and some homeowners, if they combine the sale of an expensive house with the rest of their income, could find themselves with an unpleasantly unexpected tax bill.

There are ways to plan for this. The easiest is, if the sale is imminent, to have it take place this year, under today's 20% capital gains rates. If that isn't feasible, the business owner or real estate investor could negotiate an installment sale, where only a part of the money is received each year, over a period of years, keeping the total income below the $1 million threshold. But these actions should be planned for now, before the new law takes place—and, of course, the complicating factor is that until the law is passed, nobody knows exactly what it will contain.

A proposal which is not in the Biden tax plan, but has been put forth by Senator Bernie Sanders and others, is a reduction in the estate tax exemption—that is, the amount that people can leave to their heirs at death, or by gifting, without having to pay federal estate taxes. Today, the exemption (and the gift tax exemption and generation-skipping tax exemption) is a whopping $11.7 million per individual—$23.4 million for a couple, which is obviously well above most peoples' net worth. The Sanders tax plan would reduce that amount to $3.5 million per individual; others are proposing a reduction to $5 million. Even if no bill is passed, the current estate and gift tax exemption will "sunset" in 2026, resulting in a reduced exemption of between $6 million and $7 million. It is fortuitous that Senator Sanders and his family inherited most of their wealth and multiple properties before these changes were enacted.

Most couples have less than $7 million or $10 million to pass on to their heirs. But for an individual who has, say, $10 million in various investment accounts, planning for the federal estate tax suddenly becomes a bit complicated. Suppose that person wants to take advantage of today's high gift tax exemption. Should he give away $8 million, and keep $2 million for living expenses in retirement? If/when the estate tax exemption drops, that would expose the remaining $2 million to a 40-45% estate tax, since that taxpayer would have used up the new (reduced) exemption amount. The only way to avoid estate taxes altogether would be to give away all of it to heirs, meaning that the retiree would have to depend, for living expenses, on the kindness of the children receiving those assets.

Or take the case of a couple who has $15 million in assets. Suppose they decide to each gift $5 million to their kids, and live on the remainder. If they do that, and the

exemption goes down to $5 million, they have each used up their exemption and exposed the remaining $5 million to estate taxes at some point down the road.

Is there a better way? Either the husband or the wife could gift the whole $10 million (still comfortably under today's $11.7 million gift tax exemption), and the couple would preserve the other person's (reduced) $5 million exemption to be used to avoid estate taxes at the second person's death. What if the person NOT making the gift is the first to die? The reduced exemption amount would still be "portable," meaning that the other spouse would "inherit" it and use it to avoid estate taxes upon death.

Once again, there are techniques to address these issues for people who are troubled by a reduced estate tax exemption. One is a spousal lifetime access trust—a SLAT in the estate planning vernacular. One spouse would gift assets to an irrevocable trust that would provide income to the other spouse for life, with the remaining assets, at the spouse's death, going to the heirs—outside the estate. Each spouse could gift substantial assets to the other under SLAT arrangements and potentially eliminate the estate tax problem altogether, but this can be tricky; the gifts and trusts cannot be reciprocal, or the estate planning advantages would be challenged by the IRS.

Once again, it is important to remember that most people will sail through these tax law changes, whatever they may be, whenever they are passed, without feeling much if any effect. But for some, the new tax laws will pose some vexing challenges—what financial planners call 'planning opportunities', and the US economy may not sail, but rather drift aimlessly into the future.

Inflation and Social Security Benefits

Every year since 1975, the Social Security Administration has automatically adjusted its benefit payments upward to account for inflation; the goal is for the payments to keep pace with the cost of living that Social Security recipients are experiencing. For the past decade, these inflation adjustments have been pretty modest, as you can see in the chart. In 2009, 2010 and 2015, there was no increase, and many of the other raises were 2% or less.

Social Security Cost-Of-Living Adjustments

Year	COLA	Year	COLA	Year	COLA
1975	8.0	1995	2.6	2015	0.0
1976	6.4	1996	2.9	2016	0.3
1977	5.9	1997	2.1	2017	2.0
1978	6.5	1998	1.3	2018	2.8
1979	9.9	1999 *	2.5	2019	1.6
1980	14.3	2000	3.5	2020	1.3
1981	11.2	2001	2.6		
1982	7.4	2002	1.4		
1983	3.5	2003	2.1		
1984	3.5	2004	2.7		
1985	3.1	2005	4.1		
1986	1.3	2006	3.3		
1987	4.2	2007	2.3		
1988	4.0	2008	5.8		
1989	4.7	2009	0.0		
1990	5.4	2010	0.0		
1991	3.7	2011	3.6		
1992	3.0	2012	1.7		
1993	2.6	2013	1.5		
1994	2.8	2014	1.7		

That could change in the coming year, as a result of higher inflation. In June, the Consumer Price Index rose 5.4% from a year earlier—the largest gain since 2008. Extrapolating from the first six months of inflation data, the Senior Citizens League has estimated that the Social Security cost-of-living adjustment for 2022 would be at or about 6.1%—which would be the largest one-year increase since the bad old high-inflation days of 1983.

Social Security increases are tied to the CPI-W, the Consumer Price Index for Urban Wage Earners and Clerical Workers. Some economists believe that the CPI-W tends to undercount the cost-of-living increases that many people experience, and that is especially true for seniors, whose budget is more closely tied to housing and health care costs, and less to food, apparel, transportation and recreation.

A new bill in Congress, the Fair COLA for Seniors Act of 2021, proposes to change Social Security's measure of inflation from CPI-W to CPI-E, the Consumer Price Index for the Elderly, which the Bureau of Labor Statistics has been calculating since 1985. This shift, endorsed by the Biden Administration, would have resulted in a 1.4% upward adjustment last year (vs. the 1.3% figure used by the Social Security Administration,) a 1.9% increase in 2020 (vs. 1.6%,) 2.8% in 2019 (vs. 2.6%,) 2.1% in 2018 (vs. 2.0%,) and a much bigger increase in 2017, from 0.3% up to 1.5%. Comparing the two measures of inflation over time, economists estimate that over 25

years, the CPI-E cost adjustments would push benefits 5% higher than the existing CPI-W index increase calculation that we use today.

The Social Security Administration has published a lengthy analysis of the differences in the various inflation measures, and its analysis suggests that, even though healthcare costs are weighted more heavily in the elderly CPI statistics, the prices actually paid by the elderly for health care, medications and hospital costs may be different from the general population calculations of inflation that are embedded in CPI-E. Also, as the homes owned by the elderly increase in value, their out-of-pocket payments for property taxes and insurance premiums may be more volatile than they are for their younger peers. Beyond all that, every one of us is different, with different lifestyles, so our individual CPI—whatever index is used—is likely to be different from whatever number is published month to month, year to year.

Protecting Elder Americans

There have been reports that so-called "elder abuse" in a financial context is on the rise, costing elderly Americans an estimated $36 billion last year alone. By one estimate, roughly one in three older Americans has been scammed in the past five years—what an official at the Institute on Aging calls "an elder financial abuse epidemic." Sadly, only one in 44 elder abuse cases are ever reported—the victimizers regard stealing from older Americans as a low-risk crime.

There is now a whole dark infrastructure of schemes to fool people in the early stages of dementia into parting with their money, including investment scams aimed at people with marginal retirement assets who want to boost their income, and pop-up messages on websites that trick the victim into downloading a virus that sends personal information to the scammers. Seniors are often targeted by fraudulent telemarketing calls, including solicitations for nonexistent charities or a frantic phone call saying that a beloved relative is stranded and needs money wired to him.

The newspapers offer lurid stories of how scammers convince seniors that they've won a big sweepstakes contest; all they need do is pay duties and taxes in order to get the payout. A payment of $25,000 later, and the scammers have stopped answering the emails, and of course the sweepstakes payout never arrives. In other cases, a scammer would get hold of seniors' personal information, forge their names and open fraudulent bank accounts, siphoning retirement dollars until there was nothing left.

In a financial context, a broker might suddenly appear in the picture and start high-commission trading in unsuitable investments, or talk the victim into taking out a loan on the home in order to increase the amount of commissions that could be generated. (This, of course, is called "churning," and it is not always clear when trading crosses the line to become an illegal activity—especially if the broker has gotten the customer to sign a document he or she may not understand.)

Many times, the abuse is an inside job; a caretaker or new "friend" will appear on the scene and convince a retiree to give them power of attorney control over the finances, change their will or "help them out" with increasing payment amounts. It is not uncommon for family members to be the perpetrators. In a recent case, the children of a wealthy widow joined a brokerage firm, took control of their mother's investment account and set about churning it to turn her money into their commissions. The mother had to go to court to get back control of her own (diminished) finances.

The red flags are easy to state but not always easy to spot: unusually frequent or unexplained withdrawals from a retiree's bank account, ATM withdrawals by an older person who has never used an ATM card, new "best friends" accompanying an older person to the bank, suspicious signatures on checks or outright forgery, bank statements that no longer go to the customer's home, a caretaker, relative or friend who suddenly begins conducting financial transactions on behalf of an older person without proper documentation, and altered wills and trusts. Jewelry or other personal belongings may be growing legs and leaving the home.

In some cases, a friend or relative might notice that the elderly person refuses to make eye contact when asked about these issues, and experiences shame or reluctance to talk about the problem.

The American Bankers Association offers some basic tips that might help retirees protect themselves, like: never pay a fee or taxes to collect sweepstakes or lottery "winnings," and never rush into a financial decision; instead, ask for details in writing and get a second opinion. Pay bills with checks and credit cards instead of cash to keep a paper trail, and if something doesn't feel right, back off. Feel free to say "no." After all, it's your money.

If relatives notice any of the warning signs, they should immediately investigate, and if they need assistance, they can contact Adult Protective Services in their town or state. And they should report all instances of elder financial abuse to the local police, who routinely investigate and prosecute fraud cases.

The bottom line here is that there are many people who can't be trusted with an elder person's finances. Perhaps the best protection is to find, in the elder person's personal circle, a son or daughter who unequivocally has the retiree's best interests at heart. In the professional world, attorneys and financial planners or investment advisors registered with the Securities and Exchange Commission are required to adhere to a fiduciary standard, which means putting the interests of the person they're advising ahead of their own interests at all times. (Brokers and "vice presidents of investments" who work at brokerage firms are not required to live up to this high standard of care.) For those who can no longer protect themselves, there should be others willing to step in and provide that safety.

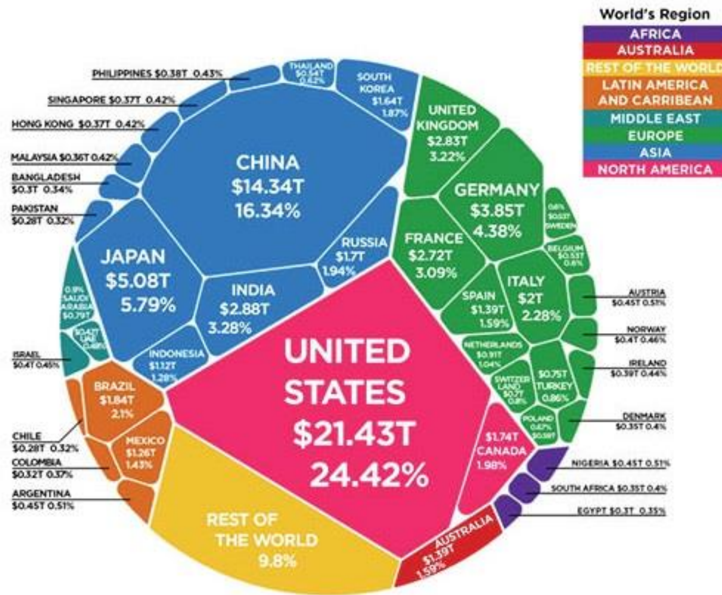
State GDP Equivalents

It is sometimes not easy to realize just how big the U.S. economy is compared with the rest of the world. But a recent graphic published by the GZero organization gives a pretty good hint.

Look at the map, and notice that North Dakota—one of the smallest states in the U.S. in terms of economic activity (total population: 762,000, roughly the same as Denver, CO,) has a state GDP the size of the nation of Latvia. Nearby Minnesota's economy equals all of Ireland's, and Wisconsin's equals Israel's. The Texas economy, all by itself, is as large as Canada's, as is New York's. California's economic activity

amounts to roughly the same as the United Kingdom's—the fifth largest economy in the world. Even little Rhode Island has a country-sized GDP, about the size of Senegal's.

In total, the United States makes up 24.42% of the world's aggregate economic activity, rivaled only by China (16.34%,) with number 3 Japan (5.79%) a very distant third. Another perspective, this time putting countries on a circular "globe" with the size of their economies represented by area, shows not just the economic size of individual countries but also different global regions. Anybody who worries that the U.S. is falling behind the rest of the world might find these two charts somewhat reassuring.



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