The BVB Group Newsletter

1st Quarter 2021

2020 was quite a year……

I'm sure many are very happy it is over, but don't worry, we won't be diving into everything that happened in this newsletter. We are all aware of what is going on globally with the pandemic, but from an investment perspective many were left wondering what the heck is going on with this market??

In many cases no one knew the market would rebound the way it did, but we do have some great resources you can read about in this newsletter that might provide an outline as to why and where we see the market in 2021.

So despite the difficult year, we are hearing form clients that there is a lot to be thankful for. Clients that have stuck to their plans have seen their portfolios and personal balance sheets increase and have more financial flexibility than they have in the past. Which have led to some fascinating conversations about how clients might use this strong market to recover and make a positive impact on what was undoubtedly a challenging year.

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MARKET PULSE (As of 9.30.2020)

Index	YTD	1 year	3 year	5 year
Dow Jones Ind Avg	(0.9%)	5.7%	10.0%	14.0%
S&P 500	5.6%	15.1%	12.3%	14.1%
MSCI EAFE	(6.7%)	(0.9%)	1.1%	5.8%
Barclays Agg Bond	6.8%	7.0%	5.2%	4.2%
Barclays Muni Bond	3.3%	4.1%	4.3%	3.8%
Barclays High Yield	(0.6%)	3.3%	4.2%	6.8%
BBgBar 3-Mo T-Bill	0.6%	1.1%	1.7%	1.2%

Source:Baird's 2Q20 Market Chartbook

The New Baird Market Gauge

In our previous newsletter we announced a new research relationship with Strategas, a macro-economic and political research firm that Baird purchase a few years ago. Their research has been integrated into Private Wealth Management and one tool we are using is the new Baird Market Gauge.

Our clients always ask us "What does Baird think about the market?" and this will help answer that question.

The new Baird Market Gauge will be posted quarterly under BairdWealth.com – "Market Insights" and it looks at 16 building blocks of market conditions. They rate them as favorable or unfavorable and ultimately add together to see a more bullish or bearish market.

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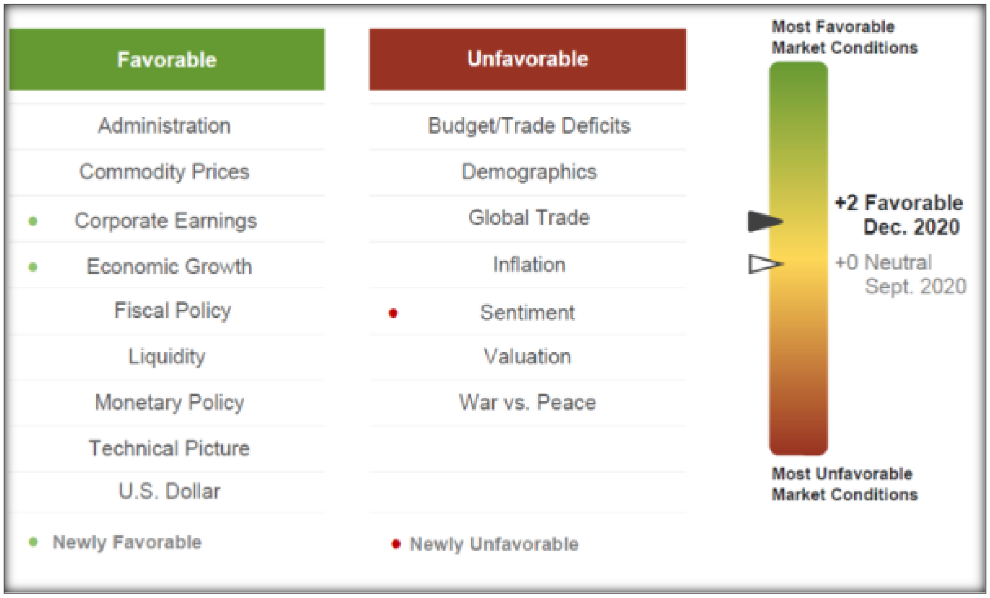

2020 Wealth Strategies Webinars

As we have done in previous years, our corporate resource group held monthly webinars on a variety of topics. All of those can be reviewed at https://www.bairdwealth.com/insights/wealth-strategies

The following topics are available now if you have an interest in learning about these areas of Wealth Management.

- Medicare Enrollment: The Good, The Bad and The Ugly
- Tax and Wealth Transfer Planning in Uncertain Time
- Planning for Families with Special Needs
- Baird Technology Update
- Planning Considerations under the CARES and SECURE Acts
- Social Security Benefits for Women
- And more………..

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Let's Get Social

If any of our clients are on Facebook, LinkedIn or Twitter, make sure you follow us or our team pages to keep up with some of the most up to date podcasts, Baird articles and updates. In an every changing environment social media can be the fastest way to see what we are thinking…..all while keeping your email inbox clear.

On Facebook: Like out page: The BVB Group – Baird Private Wealth Management
On LinkedIn: Connect with Curt Brewer, Richard Verthein and Ashley Brown
On Twitter: Follow @RickV_baird

2020 Reporting of Required Minimum Distributions

In March of 2020 Congress passed the CARES Act, which waived the requirement of taking your Required Minimum Distribution from your IRAs and Retirement Accounts. Early last year our team reached out to our "RMD eligible" clients to discuss that change and we want to clearly communicate the tax reporting that you might receive as you ensure there is not an error in completing your 2020 tax return.

Here are the scenarios around the 2020 RMD Reporting.

1. No IRA Distribution
    a. If you never took a distribution from your IRA or Retirement account, there will not be a 1099R created for 2020.

2. Took IRA Distribution and "Rolled it back" into the IRA
    a. Many clients took their RMDs prior to the CARES Act passing and moved funds back into the IRA, resulting in a non-taxable but reportable distribution. **This is still a reportable distribution and you will receive a 1099R in early February 2021 and a Form 5498 in May 2021.**
    b. All IRA Distributions are required to be reported to the IRS, but they may not be taxable. If you rolled all or part of the distribution back into the IRA you will want to let your CPA or tax accountant know that you did this. (We are also happy to do so on your behalf).

3. Took IRA Distribution and did not roll the funds back into the IRA
    a. You will receive a 1099R in early February which will report the full distribution.

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4. Made a 2020 Qualified Charitable Distribution from your IRA
    a. You will receive a 1099R in early February showing the full distribution of funds from your IRA. The amount you donated to charity will be considered non-taxable which is recorded on your 1040.
    b. Please let your CPA or tax accountant know that you made a "QCD" and note the amount and the charity.

As of January 4th, 2020 this has not been extended into 2021, so at this time RMDs must be made before December 31st, 2021.

Summary of Potential Tax Implications of a Biden Administration

By Financial & Estate Planning Dept of Baird & Updated by the BVB Group

With the 2020 presidential election complete, individuals should be mindful of the tax implications of a Biden presidency and a potential Democratic Senate. The former Vice President, Joe Biden, has proposed various changes centered around raising taxes on higher income earners and businesses. With these changes, Biden hopes to raise as much as $3.7 trillion in additional tax revenue over the next 10 years.

INCREASE IN INDIVIDUAL TAX BRACKETS

One of the key changes proposed by Biden is an increase to individual income and payroll tax for individuals with income over $400,000. He would eliminate the 37 percent ordinary income tax brackets and revert the top rate to 39.6 percent. He also intends to impose the 12.4 percent social security tax on wages above $400,000, to be evenly split between the employer and employee. This would create what some are referring to as a "donut hole", but perhaps not in the traditional way we think about it, like Medicare for example. In this instance, wages between $137,700 (the current wage cap for 2020) and $400,000 would not be subject to social security tax. Additionally, Biden intends to tax long term capital gains and qualified dividends at the top ordinary tax rate of 39.6 percent for individuals with income over $1,000,000. Currently, all long-term capital gains and qualified dividends for high income earners are taxed at a maximum rate of 20 percent (not including the net investment income tax of 3.8 percent), so this would be a drastic change for those individuals which will likely accelerate the timing of future sales.

LIMITATIONS ON INDIVIDUAL TAX DEDUCTIONS

There are several changes in Biden's tax plan related to the deductions currently allowed to be claimed by an individual taxpayer. First, he plans to implement a phaseout of the qualified business income deduction for filers with taxable income above $400,000. This is on top of the deduction phaseouts currently in place as described in provision 11011 of the Tax Cuts and Jobs Act (TCJA). Biden also plans to restore the Pease limitation on itemized deductions, which was suspended in the TCJA. The limitation reduces a taxpayer's itemized deduction by the lesser of 3 percent of income over a specified threshold, or 80 percent of total itemized deductions. On top of the Pease limitation, the tax benefit of all itemized deductions will be capped to 28 percent of their value, regardless of an individual's tax bracket. Currently, we assess the value of a deduction at our marginal tax rate. For example, an individual who itemizes on their return would receive a benefit equal to 32 percent for each additional dollar claimed as an itemized deduction. Under the proposed changes, the benefit would be limited to 28 percent of the deduction value. Whether or not the unused value will be lost is unknown; however, introducing a cap has the potential to change taxpayers' decision-making around costs like mortgage interest, or more often analyzed, charitable giving to non-profit organizations. When the standard deduction was raised under the TCJA, many analysts thought there would be a sharp decrease in donations, but research shows Americans are giving almost as much as they ever were, with 2019 being the second highest year on record for giving, even after adjusting for inflation. A surprising counter to some of these limitations is Biden's intention to eliminate the state and local tax (SALT) cap. The $10,000 limitation ($5,000 for married couples filing separately) on state and local income and property tax deductions was introduced in the TCJA and predominantly impacted taxpayers earning income in the top 1 percent. The repeal of the cap would, unlike the rest of Biden's plan, provide for a large tax break on the wealthy, causing confusion amongst many voters.

EXPANSION OF INDIVIDUAL TAX CREDITS

While the majority of Biden's plan is to increase tax rates for those with higher income, he is also introducing new tax credits, as well as increasing the value of credits currently available to individuals. To start, first-time homebuyers may be eligible for a First Down Payment Tax Credit worth up to $15,000 which would help cover the initial costs and fees associated with purchasing a new home. We saw a similar credit in the Housing and Economic Recovery Act signed by President Bush in July of 2008; however, this expired in 2010. Additionally, he would increase the child and dependent care credit from the maximum amount of $2,100 to $8,000. Under the current TCJA rules, the maximum credit is equal to 35 percent or up to $3,000 in qualified expenses ($6,000 for two or more dependents). Under Biden's plan, the percentage would increase to 50 percent and the maximum in qualified expenses on which the credit is based would be increased to $8,000 ($16,000 for two or more dependents). Of course, the eligible credit would be phased out for individuals with higher income as is the case currently. Amongst the other

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changes in Biden's plans is the expansion of the earned income tax credit for childless workers aged 65 and up, the reinstatement of the full electric vehicle tax credit and the expansion of the Affordable Care Act's premium tax credit. He has also suggested the creation of a refundable tax credit for low-income individuals and families.

CHANGES FOR REAL ESTATE INVESTORS

Investors in real estate may also experience a significant tax hit as Biden's proposal includes eliminating a tax break that has been available to the real estate industry for decades. Eliminating the 1031 exchange, commonly known as a "like-kind exchange", would be responsible for a large portion of his tax revenue goal. This section of the Internal Revenue Code allows real estate investors to defer recognition of a capital gain on the sale of business property by investing the proceeds into another business property. While 1031 exchanges have been challenged in the past, many experts still believe its elimination has the potential to discourage further investment which could drastically impact the economy.

ESTATE TAX CHANGES

Amongst Biden's tax plan are a couple changes related to the way estates are taxed. The first is a reduction of the estate tax exemption from the current $11.58 million per person. This would also mean a decrease in the lifetime gift exemption, which is the amount you can give to third parties during your lifetime without paying gift tax. Notably missing from Biden's proposals is a "wealth tax" that his Democratic opponents in the primaries had touted in their plans, however, Biden's plan does include the elimination of the step-up in basis at death. Consequently, when an individual inherits property, they will receive a carry-over basis equal to the decedent's (the original owner's) original purchase price. It is unclear whether the

gain would be recognized when the property is inherited or when the property is later sold. For those who lack the records of when those assets were purchased and for how much, tax will be assessed on the full value of the property. Both changes could mean a significant increase in tax on assets passed on to beneficiaries.

PLANNING FOR A BIDEN ADMINISTRATION

Those with lower income, will likely want to stick with the usual strategy – **defer income into next year and accelerate deductions into this year**. **However, those with higher income earners may wish to abandon the typical deferral strategy.** With Biden's intention of reverting the top tax bracket to 39.6 percent, those with higher income will likely want to accelerate income, to the extent possible. Assuming it is sound from an investment standpoint, taxpayers with executive compensation might exercise their nonqualified stock options (NSOs). Upon exercise, the spread between the stock price on the exercise date and the strike price will be recognized as ordinary income, while the top tax rate is at a comparatively

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lower 37 percent. Additionally, the earned income on which social security tax is assessed would be limited to $137,700. For those that took coronavirus-related distributions (CRDs) in 2020, the income recognition can be picked up ratably, over 3 years, or an election can be made to pick up 100 percent of the distribution in the first year (2020). Individuals who are consistently in the top tax bracket, and do not intend on repaying the CRD, may wish to make the first-year election, before the top rate increases. Individuals exceeding the $1 million threshold might consider accelerating capital gains into 2020, while the top bracket remains at 20 percent. Individuals who are in the process of implementing a gain deferral strategy, such as a like-kind exchange or an investment in a qualified opportunity zone, should consider intentionally failing these transactions, thereby causing the gain to be recognized immediately. Additionally, taxpayers might want to postpone harvesting losses until those later years, when they can offset long term capital gains that would otherwise be taxed at ordinary income tax rates under a Biden administration. For many, accelerating itemized deductions may prove beneficial, as there's potential the benefit of these deductions will be limited in future years should Biden be elected. The use of a donor advised fund would be especially significant for wealthier individuals, while the tax benefit of the contribution does not have a cap. There is potential that the SALT cap is eliminated entirely, allowing for an increased deduction in future years, yet subject to Biden's other proposed limitations. Therefore, taxpayers who have already reached the $10,000 threshold for 2020, or who will be claiming the standard deduction this year, should defer any additional state tax payments until 2021. Regardless of income levels, individuals should begin their conversations now and have an easily triggered tax plan in place under either presidential candidates' election. ***While Vice President Biden has stated his intent to make various other changes in the tax code, the provisions mentioned above will provide for the majority in tax revenue and will likely have the largest impact on those with higher income. Making changes to tax policy takes time, though, and involves compromise, meaning it is unlikely that we'll see an immediate change.***

Happy New Year!! Cheers to 2021

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