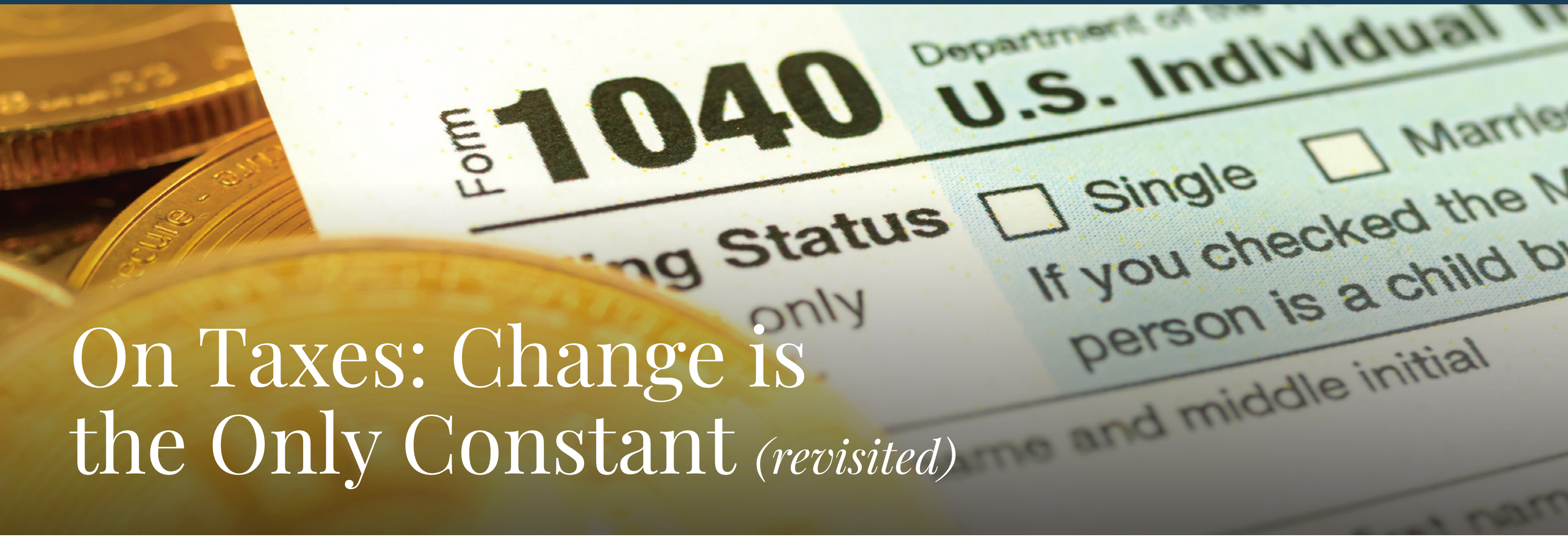

On Taxes: Change is the Only Constant *(revisited)*

We know many of you are worried about taxes. Especially for those of you in or about to start retirement, taxes and inflation can quickly impact the purchasing power of your portfolio. When expected rates of return are already low, a potential change in the tax laws is just another thing that can give you indigestion.

Last month we shared in our letter the details of the tax proposal attached to the Build Back Better Act. As we alluded, changes were going to be made – and more changes are yet to come before the final version is approved. **In the latest iteration, some of the more impactful proposals have been left out as the social & climate spending bill has been scaled down from $3 trillion to $1.75 trillion. Again, when it comes to taxes, plan for the game to constantly change.**

The first bill included language that would place individuals with an annual taxable income greater than $400,000 ($450,000 for Married Filing Jointly, or “MFJ”) in the highest marginal tax bracket (vs. $523,600 or $628,300 MFJ, currently). And the rate for the highest bracket would increase from 37% to 39.6%.

All that is now gone. Instead, the new proposal is for a 5% surtax on taxable income above $5.0 million ($10.0 million, MFJ). Another 3% surtax would kick in over $25 million. In addition, the increase in the capital gains tax (up to 25% for the highest rate) was left out. Thus, instead of impacting a broader group of wealthy families, it is now targeted at the ultra-wealthy.

There were several other items excluded in the new proposal offset by a handful of new additions. But the key is, again, that tax laws (and bills) are ever changing, and the “policy pendulum” will continue to swing back and forth through the cycles.

Which leads us to the critical point we are making: there are winners and losers to these changes, or any tax or regulatory changes for that matter, but you can still control how you plan for and react to these changes.

Remember to look for the silver lining. In the case of investments, tax and regulatory changes can cause disruptions in the capital markets that create big opportunities for skilled investment managers. **This is one of the reasons why we prefer to be active managers of individual stocks and bonds – when the baby gets thrown out with the bath water, there are usually great investments to be made.**

When the Affordable Care Act was passed in 2010, the uncertainty around the changes penalized many healthcare stocks, but several of these companies turned out to be beneficiaries and thus great investments.

More recently, the Paycheck Protection Plan (“PPP”) loans and Covid-19 stimulus funds in 2020 resulted in a fast recovery for companies that the capital markets left for dead – again, creating opportunities for patient hands.

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The bottom-line here is that NPF has been at this since 1933. Our firm has lived through a lot of cycles of tax and regulatory change. (Heck, we saw 94% marginal tax rates in 1944!) While tax changes can be a negative on one side of the equation, it can be a positive on the other side when you are able to skillfully navigate through those changes and find opportunities. Again, this proposal is not official yet, but we will continue to monitor this closely and be prepared to evaluate it on your behalf.

Lastly, we should point out that the significant increase in complexity to the tax code over recent decades has only increased the rewards for prudent planning. NPF has been on the forefront of integrating both savvy planning and investment management into a comprehensive client strategy – such as knowing what the real value of specific tax-free municipal bonds are for a client based on their tax status and making appropriate "asset location" decisions when clients have both tax-exempt and tax-deferred investment accounts. Going forward, we expect to have more conversations around Roth conversions, charitable giving, and estate tax mitigation.

We continue to be grateful that you trust us to help you and your family through this ever-changing world. Our goal is to take advantage of the complexity to unlock value for you, then explain it in a simple, jargon-free way. If you haven't had a planning conversation with us, please reach out to your advisor to schedule an appointment.

Sincerely,

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