KEMP Financial Management, LLC

October 2021: Filet Mignon or Beans and Franks?

"In 2014 we had a terrible thing happen to us. Our trusted family friend and financial planner, we learned, had been operating a Ponzi Scheme, and he had stolen all our inheritance money and retirement funds. I have a small teachers' retirement monthly check and both of us have our social security checks – that's it. (He is serving 25 years in Federal prison.) All of this to tell you that our retirement looks very different from what we had planned."

-Personal note from Bill and Carole, August 2021

This is a story we've heard all too often from folks that should be enjoying the best times of their lives in retirement. It's a story that is told, what feels like daily, as our financial publications report about financial advisors across the country that have betrayed their clients. Sometimes it's the Ponzi Scheme, other times its simply using client funds for their own personal gains.

Sadly, social media platforms have become a place for advisors (licensed and unlicensed) to lure unsuspecting investors into advisor/client relationships that turn out like Bill and Carole.

It's stories and situations like this that have shaped and formed our investment policy at KFM. Back in the early nineties, the firm committed to only recommending investments that are daily valued, daily liquid. The firm committed to "evidence based" asset class investing, using multiple asset classes to provide proper diversification for customizing client recommendations based upon their personalized situation.

On Thursday, November 4th, we will be holding a special webinar, with guest speaker and friend, Apollo Lupescu. While we will not be addressing the situation like Bill and Carole directly, we will be addressing topics of importance that can have impact on your future "dining choices". For existing clients, we have already instituted much of what will be discussed on the 4th. However, for friends, family and colleagues of our clients, we feel it's a webinar that people will not want to miss. This will be relevant and entertaining and we hope you have the time to participate.

Apollo Lupescu, PhD

If you have not registered already or you would like us to send an invite to a family member, friend or colleague, please contact Kate via email at kcoogan@kempfm.com or simply contact anyone at the office at 714-257-0800.

(After reading this, if you are concerned about KFM, rest assured KFM has created a layer of protection for all of our clients with the relationship of a custodian holding all of our client assets in safekeeping. KFM does not have access to client funds and utilizes an investment strategy where assets are daily valued and daily liquid. Feel free to discuss this in more detail during your next update meeting.)

Capital Markets Update

You will notice your quarterly statement for this quarter ending will have a slight decline for the quarter, however the year-to-date gain remains above our expectations for the year. September lived up to its expectation, meaning, September is traditionally the most volatile and negative month of the calendar year.

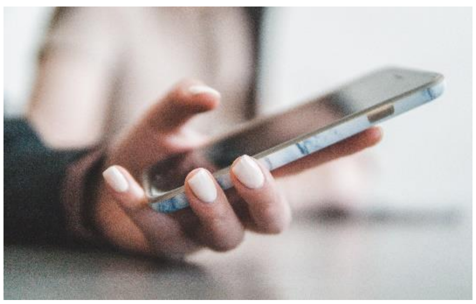
The KFM Investment Committee met at the close of the quarter to review the asset classes and investments held in our client accounts. We are excited to report all asset classes and holdings performed up to our expectations for the quarter. Therefore, we continue to believe each of our clients are invested properly to reach their goals.

Where will the capital markets go from here? We continue to believe over the next five years the capital markets will go up from here. How they get there is anyone's guess. There is pressure on the capital markets with continued flare up of the pandemic, distribution of goods and services (supply chain), inflation and proposed tax changes and proposed government spending. Lastly, we hope the Government can reach an agreement to avoid "default" (which we believe they will). Even with this pressure, we continue to believe our approach to investing our client assets is best suited for working through each of the issues to allow our clients to continue to pursue what matters most in their lives.

We look forward to meeting with you virtually or in person over the upcoming weeks and months for your update meeting. Should you have any questions relating to the capital markets, your quarterly statement or custodial statement, please feel free to add that to agenda at your next update meeting.

KFM Update – Texting

Like many of you, we have found most communication with one another is back to old school, the telephone. While email is still effective, it's certainly not as convenient as the phone. The difference in today's telephone world is its no longer connected to the wall in your kitchen or sitting on your desk, it's the phone that follows you everywhere you go. The added benefit of the modern-day phone is the ability to communicate via text.



Back in 2019, we initiated a campaign to establish text communication with our clients and KFM. While it's not quite as simple as texting smart phone to smart phone, it's pretty close. Due to Securities and Exchange Commission electronic communications regulations, KFM must establish a relationship with a third-party provider to maintain historical record of all client communication including emails and text. KFM has chosen to work with Redtail Speak to provide this service for all text communication. Here's how it will work:

- We will be sending an opt in message coming from (949) 518-1930.
  - Your "opt in" message will look like this: "Kemp Financial would like to connect with you via text message. Please call us with any questions @ 714-257-0800. Please send the word "yes" if you would like to connect."
- You will need to respond "Yes" to allow for the texting. If you do not want to text, feel free to say "No" and we will continue communicating as we always have.
- We recommend that you save the phone numbers as Kemp Financial Management Text
- Any text you send to KFM during normal business hours will be available for access by all KFM Team members. We will respond to your text as soon as possible.
- Trades, request for disbursements, address change or any other account service needs cannot be accepted by Text.
- Disclosure – all standard messaging and data rates will apply
- We promise not to abuse texting privileges.

Thank you for setting up text communication with KFM. We are hopeful this is an added benefit for you as we look to enhance our continued communication with one another.

Annual ADV Part 2 and Privacy Policy Announcement

You received your copy of our ADV Part 2 at the time you became a client. Every year, we offer a complimentary copy of our most recent ADV Part 2 for your review and files. If you would like a copy of the most recent ADV Part 2, please make your request by contacting Kate at 714-257-0800 or by e-mail at kcoogan@kempfm.com.

We take privacy of information very seriously. To that regard, our Privacy Policy for 2021 is included with the mailing of this Newsletter for your review and files.
Please note, the ADV Part 2, Privacy Policy and Client Relationship Summary can be downloaded directly from our website as well as your client portal. Visit www.kempfm.com where you will find a link to each document at the bottom of each page.

Happy Thanksgiving!

Thanksgiving is upon us. As we meet over the upcoming weeks and months, let's remember the spirit of Thanksgiving and gratitude. We are so thankful to be a part of your life and we look forward to discussing your desires and dreams in our upcoming meetings. We also look forward to hearing your creativity as you plan your Thanksgiving celebrations with family and friends.

As always, we are here to help in any way. Please feel free to give us a call to set up a virtual visit for your next update meeting. Stay safe, healthy and connected!

PS - This quarter, we created Legislative Update as a separate part of the Newsletter. Sadly, it doubles the length of this newsletter and could have easily been more. We did our best to highlight areas that might impact clients most at the beginning. The majority may have very little influence on your personal situation, but we still think it might be worth the read to gain a better understanding of what is being discussed in Washington.

Legislative Update – October 2021 Newsletter

There is a lot going on in Washington, D.C. The last two newsletters "hinted" at <u>potential tax law changes</u> and now we have the proposed changes in "print" form. Remember, <u>this is nothing other than a proposal, so none of it is Law.</u> There are a few proposals that have effective dates of September 2021 while others would begin in 2022. <u>By no means, should you make any adjustments based upon a proposal.</u> However, during the 4th quarter update meetings, we would encourage you to ask questions about proposed changes that may impact your personal situation. Clearly, we will also call them to your attention as well. <u>For the most part, the changes will not effect the majority of our clients, but we still believe it's important for you to be aware of the changes.</u>

<u>Let's start with what's "NOT" in the Bill</u>:

- Nothing on SALT (State and Local Tax Deduction)
- Nothing on addressing Social Security
- **<u>No elimination of the step-up (This is Big)</u>**

Here are the proposed Estate Tax Changes:

- Reduction in the Unified Credit Amount (effective 2022)
    - The estate and gift tax exclusion would be <u>halved</u> (essentially undoing the TCJA's change)
    - This seems like a very likely outcome. Accordingly, single clients with assets in excess of $6MM and married clients with assets in excess of $12MM (or those whose assets may grow there over time) should carefully consider making large gifts prior to the end of 2021, so as to maximize the current exemption amount
- Maximum reduction in value for assets used in family farm or family business increased (effective 2022)
    - Assets used in family farms/biz can be valued using an "actual use" value instead of at FMV, subject to a max difference of $11.7MM

Now, let's focus on potential income tax changes:

- A new top ordinary income tax bracket of 39.6%, and 'scrunching' of the 32% and 35% brackets (effective for 2022)
    - The new top rate of 39.6% would apply to single filers with taxable income in excess of $400,000, and joint filers with taxable income in excess of $450,000 (both lower than proposed by President Biden in his recent budget request)
    - The 32% bracket would get modestly compressed (less income would fit in it before a client gets bumped to the next bracket), while the 35% bracket would be *substantially* compressed, further increasing the tax liability of affected clients
    - My take: <u>The biggest "losers" here are those with taxable income of between about $400k to $1MM, as they will see the greatest increase in average rate paid on their incomes</u>

- A new top long-term capital gains bracket of 25% (effective *checks watch* … **today**!!!)
    - A new top rate of 25% would apply to long-term capital gains attributable to taxable income over $400,000 for single filers, and $450,000 for joint filers (a much lower top rate than the 39.6% proposed by Biden).
    - Note that the top LTCG and top ordinary income tax brackets would be re-aligned (start at the same taxable income levels), which had been the case prior to the passage of the TCJA
    - If enacted as written, the new top rate of 25% is already in effect, As of, September 14th. (There was an exception for binding contracts in place as of September13th but have not yet closed).
    - <u>There is NO ELIMINATION, NOR ANY LIMITATION OF THE STEP-UP IN BASIS. It remains an unlimited.</u>
    - My take: <u>The biggest "losers" here, relative to the Biden proposals, are (once again) those with incomes of about $400k to $1MM.</u> Notably, they would have seen no increase in their top capital gains rate under the Biden plan (b/c while the top rate would have been higher, it was only going to 'kick in' at income about $1MM), but now they face a potential 5% increase in their top LTCG rate

- Child Tax Credit
    - Permanent refundability
    - Continues monthly CTC payments (technically done through two different provisions) through 2025

- All sorts of fun tiebreakers to see who may be able to claim the credit in non-traditional circumstances

- 2021 version of the Child and Dependent Care Credit made permanent
  - Larger max potential credits (about 4x "old" amounts)
    - $8k w/ 2 or more qualifying children
    - $4k w/ 1 qualifying child
  - Credit available at higher incomes
    - Fully phased out at $500k
  - Fully refundable

- NEW Caregiver credit
  - Max $4k credit
  - Equals 50% x qualified costs, before phaseout
  - Phaseout begins at $75k

<u>Other Notable Changes</u>

- The Wash Sale rule would apply to crypto transactions beginning **January 1, 2022**
  - This might be a good time to reach out to clients with crypto investments at a loss to have them sell, lock in the loss, and then buy back the investment shortly (maybe a day?) later
- The limit on excess business losses would be made permanent
  - Joint filers can't use more than $500k of business losses to offset non-business income
  - Single filers can't use more than $250k of business losses to offset non-business income
- Extension of Premium Assistance Tax Credits for the unemployed
  - Would treat individuals receiving unemployment benefits as if their income is 150% of the Federal Poverty Limit through 2025

Lastly, let's focus on Retirement Account Changes:

- Future prohibition on Roth conversions for those with high income (effective in 2032)
  - Taxpayers with income in excess of an applicable threshold would be prohibited from making a Roth conversion
  - Applicable thresholds are as follows
    - Single filers: $400,000
    - Joint filers: $450,000
    - Note that these amounts are ATI – that's NOT a typo – this would be an "Adjusted *Taxable* Income" calculation
- No more conversions of after-tax dollars (effective 2022)
  - This would be (and is the likely) end of the Back-Door and the Mega-Back-Door Roth
  - Would apply without regard to income (doesn't matter how much you make, you wouldn't be able to do it)
- New RMDs for high-income AND high-net-worth clients (as in you need to have both for this to apply) (effective 2022)
  - To the extent a client's income exceeds an applicable threshold <u>*and*</u> they have retirement account balances in excess of $10MM, they will be subject to additional RMDs
  - Applicable income thresholds are as follows
    - Single filers: $400,000
    - Joint filers: $450,000
    - Note that these amounts are ATI (like above)
  - The RMD will be equal to:
    - 100% of total retirement account balance in excess of $20MM, PLUS
    - 50% of total retirement account balance in excess of $5MM
  - RMDs (due to 'excess' retirement account balances) must come first from Roth IRAs, then from plan Roth accounts, and only then from other pre-tax accounts of the client's choice
- Prohibition on new IRA contributions for high-income AND high-net-worth clients (as in you need to have both for this to apply) (effective 2022)
  - If a client has total retirement accounts in excess of $10MM and income above the same thresholds noted above, they cannot make IRA contributions
  - Their ability to make contributions to employer-sponsored retirement plans is NOT impacted by this provision

We are not tax professionals at KFM and we encourage you to discuss any of this material with your CPA or tax advisor. Again, <u>we believe you should never let the "tax tail wag the dog", meaning any changes that you consider making, should always be in alignment with your personal vision first. Taxes are simply part of the process.</u> (Source: **Jeffrey Levine, CPA/PFS, CFP®, AIF®, CWS®, BFA,** Chief Planning Officer Buckingham Asset Management.)

Thanks again for being a part of KFM. We look forward to discussing much of the enclosed material with you before the end of the year. In the interim, stay connected, safe and healthy!