The Papyrus

Third Quarter 2020

The Rules Have Changed

Modern portfolio theory, capital asset pricing theory and passive asset allocation have always had a major weakness. Determining the right asset allocation looks at the past and the relationship of asset classes and risk over time. Covid-19 has just dealt a body blow to the ability to anticipate the future based on the past.

The post-Covid world will be one of change for equity markets worldwide. Industries and companies that were portfolio standards three months ago are fighting for survival. Over 30 million people in the U.S. alone are unemployed and a staggering number of jobs may never come back. Countries have never shutdown their economies for over two months with the possibility of still further shutdowns. We are in uncharted territory.

Time to panic? Of course not. What it is time to do is to move past rules and strategies created in the low technology, stable markets world of the 1950s and 1960s and look forward. History hasn't been here before. We need to react to the present. On our side is technology, global communications, manufacturing flexibility, all-in-all a well educated population and the desire to rebuild normalcy.

Coronavirus could be with us for a long time. Business models are going to change, and innovation will determine the winners. Restaurants, airlines, recreational travel, entertainment complexes, destination resorts, commercial real estate, oil, and small retail, along with segments of other industries hardest hit by the shutdown are in a world of hurt. For the near term, selected medical, digital services, cleaning products, and robotics industries have benefited.

Within the investment advisory industry, we are changing as well. As an essential business, work has gone on but we are adapting new technologies to work better with employees in remote locations, to keep in touch with clients and stay aware of their changing needs. We are looking at what worked and what didn't strategically during the market's collapse in

continued on page 2

CARES Act Financial Considerations

The Coronavirus Aid, Relief, and Economic Security Act (CARES Act) included some important changes to charitable gifts, emergency withdrawals and loans from retirement accounts, deductibility of losses on taxes and even the required minimum distribution for those over 70½. The following highlights important changes that may affect you.

The true cost of the COVID-19 pandemic will only be known in hindsight, but it is causing economic disruption at unprecedented speed and scale. The CARES Act, which was enacted on March 27, 2020, is estimated by the Congressional Budget Office to increase the federal deficit by about $1.7 trillion over the 2020-2030

continued on page 3

Wealth is Limitless

Perhaps the most intriguing aspect of wealth is that it is limitless. There is no fixed amount of wealth available in the world, no pie of wealth where one person's wealth reduces another's share.

Wikipedia defines wealth *as an abundance of valuable financial assets or physical possessions which can be converted into a form that can be used transactions*. But that overlooks a very important characteristic of wealth – Wealth can be created. It is not a zero-sum game. Becoming wealthy or wealthier doesn't require taking value away from someone else. The pie is not fixed in size nor by the size of a single slice.

The creation of wealth is directly tied to the ingenuity, resourcefulness, and hard work of individuals. It can be taken away, exploited, stolen and lost, but it can only be created by ingenuity, resourcefulness and hard work. And that is what creates the potential for people in a free society to become wealthy.

Ingenuity is the ability to create or improve a product or service that others want and are willing to pay a premium over the cost of providing the product or service. Resourcefulness is seeing an opportunity for profit that others have overlooked and finding ways to take advantage of that opportunity. Hard work is the willingness to invest sweat equity to create value. Becoming wealthy is rarely easy, but the possibility exists. The decision is yours.

Should You Convert Your Traditional IRA to a Roth IRA?

If your income is likely to take a hit in 2020 due to the coronavirus pandemic and you have a sizeable balance in a tax-deferred IRA, this may be a good year to consider a Roth IRA conversion. In some states, unemployment is not considered taxable income (make certain you understand your state's rules), which may help keep your taxable income low.

A traditional IRA, where contributions are deducted from taxable income, is in many ways a ticking tax bomb. Gains accumulate tax free over the life of the account, but all distributions are taxed at your personal tax rate when withdrawn in retirement. If you have done a good job of accumulating assets in your IRA, required minimum distributions could put you in a relatively high tax bracket, making your Social Security payments taxable and increasing the amount you will be required to pay for Medicare.

Prior to the 2017 tax law changes, if you died with a sizable balance in your IRA, your beneficiaries could "stretch" that balance out over their lifetime with an inherited IRA. Now, for most non-spouse beneficiaries (there are four exceptions), inherited IRA funds must be distributed within ten years, potentially creating adverse tax consequences for your heirs.

A Roth IRA is funded with after-tax contributions. Federal and state income taxes have already been paid on contributions to the account. Gains then accrue tax free over the life of the account. When Roth IRA distributions are taken in retirement, no income taxes are due. Because Roth withdrawals are not counted in your income, they may not affect your Medicare costs or the taxability of your Social Security payments. In addition, you can withdraw your original contributions at any time, regardless of your age, without an early withdrawal penalty because you have already paid taxes on those funds. Regular withdrawals can begin at 59½, similar to a tax-deferred IRA. In addition, a Roth IRA does not have Required Minimum Distributions.

Converting a tax-deferred IRA to a Roth IRA has one major requirement. You must pay income taxes on the full amount rolled over into the Roth account. If you use funds from the tax-deferred IRA account to pay the taxes, it counts as a withdrawal and may be subject to an early withdrawal penalty as well as personal income taxes. Because the rollover amount counts as income, it could push your personal income tax rate into a higher bracket, which is why making a rollover at a time when you have minimal income can be beneficial. Tax brackets are also at their lowest level in many years as a result of the 2017 tax law changes.

If you believe, as we do, that higher personal income taxes at both the state and federal level may be inevitable due to the financial impact of the coronavirus pandemic, a Roth IRA may minimize your taxes in retirement and provide you with greater after-tax retirement income.

To explore the benefits of a ROTH IRA conversion and to make certain you follow the rules and avoid any penalties, talk to your financial advisor.

The Rules Have Changed *— continued*

late March and ongoing volatility. We need to know how our investment strategies and the services we offer our clients can be better.

As a country, we went into this disaster too complacent. Too sure that it couldn't hurt us. It's easy to blame the federal government. But the failures were far more widespread. Where were the corporate leaders, the media, the policy nerds, the intelligence agencies? What was the CDC doing, other than assuring the public that it was a non-event as far as the U.S. needed to be concerned? There were red flags, why were they ignored? Could slowing the spread of the disease have been handled better?

Covid-19 is serious, but it is survivable. We are going to come out of this stronger with a lot of lessons learned. In the meanwhile we want to hear from you, our clients. How has your financial world changed? Do we need to modify your portfolio in response to those changes? Is it time to take another look at your financial plan? If we can't meet in person, we can definitely take advantage of our recent crash course in online meetings. Please call and let's schedule a time to talk.

period. Travel, recreation and restaurant industries have been financially devastated. Tax collections have plummeted, damaging state and municipal budgets.

While it might be tempting to think there is little one can do to counter the impact of the pandemic, there's actually a great deal one can and should be doing with respect to financial issues.

CARES Act Opportunities

- Charitable Contributions
- Retirement Accounts
- Loss Carry Backs

Encouragement of Charitable Contributions

Beginning with the 2020 tax year, taxpayers who take the standard deduction are allowed to deduct up to $300 from taxable income (in addition to the standard deduction) for qualifying charitable contributions made in cash.

For those taxpayers who itemize deductions, qualifying charitable CASH contributions to an eligible public charity during 2020 can be deducted up to their Adjusted Gross Income, less all other charitable contributions otherwise deductible for the year under the normal charitable contribution limits. Contributions made to donor advised funds and 509(a)(3) supporting organizations are excluded.

The law also increases the income limits on contributions of wholesome food inventory made during 2020 from 15% to 25%.

Contributions in excess of the allowable amounts can be carried over to the taxpayer's subsequent tax year and will be subject to the limitations in place under the existing laws.

Early Withdrawals and Loans from Retirement Funds

Early withdrawals up to $100,000 from retirement accounts for "coronavirus-related distributions" can be made per individual without the 10% early withdrawal penalty. Amounts withdrawn may, at the election of the taxpayer, be reported as taxable income ratably over the 2020, 2021 and 2022 tax years. Or, the individual may repay up to the amount distributed to an eligible retirement plan any time during the three-year period beginning on the day after the date the distribution was taken.

To qualify as "Coronavirus-related distributions," distributions taken on or after January 1, 2020 and before December 31, 2020 need to be made to:

- An individual diagnosed with COVID-19 by a CDC approved test,
- An individual whose spouse or dependent has been diagnosed with COVID-19, or
- An individual who experiences adverse financial consequences as a result of being quarantined, furloughed, laid off, having work hours reduced, unable to work due to child care needs or closing or reduction in hours of a business operated by the individual.

The CARES Act increases the amount an individual can **borrow from a qualified employer plan** from $50,000 to $100,000 and employees may borrow up to the present value of their entire nonforfeitable balance in the plan (versus the previous 50% limitation). This law is in effect for a 180-day period from the date the law was enacted (March 27, 2020). Any payments due between March 27, 2020 through December 31, 2020, including loans existing prior to the law being passed, are delayed for one year.

Temporary Waiver of Required Minimum Distribution Rules

To help investors conserve their retirement assets in the wake of the coronavirus pandemic and the associated market volatility the CARES Act includes a temporary waiver for 2020 RMDs, as well as added flexibility to "roll back" RMDs to an IRA or employer-sponsored plan. It applies to both:

- 2020 RMDs, including ones from IRAs, inherited IRAs, and employer-sponsored plans such as 401(k) plans.
- 2019 RMDs due by April 1, 2020, for individuals who turned 70½ last year and didn't take the RMD.

Delay in Effective Date of Limitations on Deductibility of Losses

The Tax Cuts and Jobs Act of 2017 limited an individual's ability to deduct trade or business losses in excess of certain thresholds (known as the "excess business loss" limitation), starting with the 2018 tax years. The CARES Act delays the effective date until the 2021 tax year. Taxpayers who were subject to this limitation on their 2018 and (if filed already) 2019 tax returns can amend these returns to claim a refund.

Taxpayers that incurred a net operating loss in taxable years beginning after December 31, 2017 and before January 1, 2021, may carry back these losses to each of the five taxable years preceding the taxable year of the loss. Taxpayers that do not wish to carryback losses generated in 2018 and/or 2019 must make an election to forego the carryback periods by the due date (including extensions) of their return for the first taxable year ending after March 27, 2020. The law removes the 80% taxable income limitations and allows for taxpayers to fully offset their taxable income for tax years beginning before January 1, 2021.

This is a very condensed explanation of the CARES Act changes and is intended for informational purposes and not as financial or tax planning advice. Please consult with your financial advisors before taking any action on this information.

Now May be a Good Time to Give Away Assets

The Tax Cuts and Jobs Act, enacted in December 2017, temporarily increased the Basic Exclusion Amount (BEA) from $5 million to $10 million for large gifts from estate and gift taxes for tax years 2018 through 2025. Both dollar amounts are adjusted annually for inflation. The tax year 2020 estate and gift tax exemption is $11.58 million per individual, up from $11.4 million in 2019. An individual can leave $11.58 million to heirs and pay no federal estate or gift tax, while a married couple is able to shield $23.16 million. An unlimited number of annual gifts can be made up to $15,000 per individual and excluded from gift taxes.

A number of concerns were raised with respect to the BEA because the higher exclusion amount reverts to pre-2018 levels at the end of 2025, barring any subsequent tax law changes. Would that make gifts made during 2018-2025 then taxable at 2026 levels? In November 2019, the Treasury Department and Internal Revenue Service issued final regulations confirming that individuals taking advantage of the increased gift and estate tax exclusion amounts in effect from 2018 to 2025 will not be adversely impacted after 2025 when the exclusion amount is scheduled to drop to pre-2018 levels.

The 2017 tax law and subsequent regulations affect ONLY federal estate and gift taxes. Individual states have their own estate and gift tax requirements.

Given the burden of new federal debt resulting from CARES Act and the precarious financial situation of many states resulting from the loss of income during stay-at-home shutdowns, higher taxes seem inevitable. There may even be a greater push to repeal the Tax Cuts and Jobs Act. Asset prices may also be depressed in the current environment stretching the assets that can be included under the $11.58 million and $23.16 million limits and increasing the overall tax savings from large gifts. As a result, if you have been considering large gifts, this may be the year to do so.

The preceding is for informational purposes only and should not be considered financial or estate planning advice. Every situation is different. Before you make major gifts, talk with your financial consultant and make certain your decision fits your circumstances. You do not want to damage your own financial security or take a chance on outliving your remaining financial assets. There may also be situations where you are the best administrator for those assets.

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