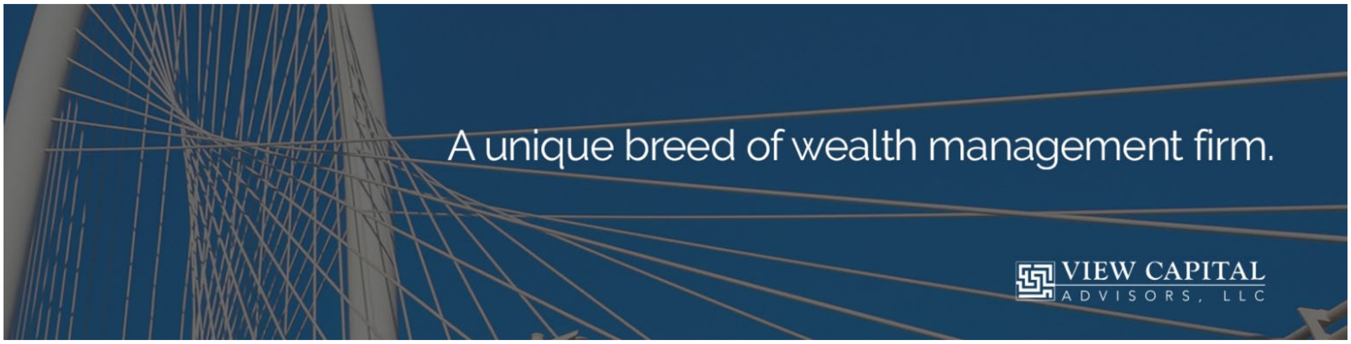
Panorama

December 2021 ISSUE 42



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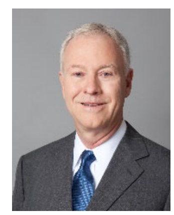

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LONG-TERM CARE CONSIDERATIONS

We all age. A variety of factors, sometimes including just the luck of the draw, will impact the degree to which we will be able to live independently and care for ourselves the rest of our lives. For those who have travelled the painful, expensive and exhausting long term care road for a family member, it is a stark awakening that many of us may require others to help care for our basic activities of daily living at some point in life. And the responsibility of managing this process is definitely not easy.

In a recent discussion with Paul Markowitz at Senior Living Specialists in Plano, TX, he enlightened me on the current costs of providing long-term care in the Dallas/Ft. Worth markets. First, break the care venues into two paths - those who need care assistance and want to live and die in the comfort of their own home and those who need help and are willing to move into to a care facility, generally referred to as “assisted living”. Paul is a longtime DFW consultant who helps match up elder care needs with care options. He has been particularly helpful to me and my family in understanding the care options and landscape, and which option was the best fit for my dear old mother’s needs.

For those desiring home care, there are many in-home care providers to choose from. However they are expensive. The going rate varies between $25 - $28/hour and that does not include a registered nurse as a care provider. What you will get is a care provider trained to help with everyday tasks including personal care, meal preparation, and running errands including transportation to doctors' appointments or the barber shop. Doing the math for the worst case scenario, if you require 24/7 care in-home at $25/hour, it costs you $600/day or $18,000 per month. This also does not account for any costs required to remodel passage ways in your home to facilitate wheel chairs or bathrooms depending on the level of incapacity. Also, a full day's care will generally result in a shift of 3 care providers coming and going on any given day. My personal observation is that each care provider is a different person and some may be more or less well received by your loved one receiving the care.

Behind door number two is the assisted living route. By the way, today's assisted living facilities are luxury resorts or a cruise ship compared to the "nursing homes" that our parents took us to for visits to Aunt Sally back in the 1970's. Most modern facilities also cater to providing varying levels of care within the same facility. The older you get, the harder it is for an elderly individual to mentally adjust to a new living environment, so it is helpful to associate with multiple care level facilities.

For those individuals who are older but fully capable of self-care, independent living in a facility in an environment where others are nearby and able to frequently check in on them may be the right choice until a higher level of care proves necessary. Incidentally, all assisted living facilities will have one or more registered nurses on site at all times. Generally, dentists come to the facilities to do their periodic cleanings and exams.

Care levels and costs can increase up the highest level of care for dementia and Alzheimer's memory care or severe physical incapacity. These facilities are largely "all inclusive", meaning all of your normal bills, meals, laundry, cable TV, etc. are included in the monthly rent except in some cases for personal toiletries.

The DFW cost today ranges from $6,000 to $7,500 per month, call it $80,000 - $90,000 per year. You may see outliers above and below these ranges, but this range covers most modern facilities. And you should expect to see cost of living rent adjustments every year or two. I was informed that the average stay in an assisted living facility is around 4 years. My mom made it 4.2 years in various stages of assisted living before she passed at age 89.

The logical follow-on question is how one pays for any of these expensive care options? Basically, there are five choices:

1. **Pay from your personal savings or investment accounts.** This assumes you have savings or investments to be able to pay the LTC bills. In many cases, a variety of these methods may be combined to cover an individual's LTC costs.
2. **Government programs.** Social Security and Medicare do not cover LTC. Of the few federal and state programs that do provide assistance, they are generally only available to low income

families. An individual's social security retirement benefit can be used to self-fund LTC expenses but there is no ability to bill Social Security directly for these charges.

3. **Traditional long-term care (LTC) insurance policies.** These are typically older LTC policies where you pay a monthly premium for a specified period or life. The policy will pay a defined amount of coverage for LTC costs over a defined period and with a waiting period before benefits start once a claim is made. If you die before receiving the full benefit, there is no refund. These policies have largely proved unprofitable for insurance companies who are either discontinuing them, reducing benefits or raising the premiums.
4. **New Hybrid policies.** These LTC policies are a newer breed built on a life insurance product chassis. The life insurance design allows the policy to leverage the amounts they can pay for LTC costs, and the death benefit. Here, it is possible for you or your family to be reimbursed for the premiums spent to secure the policy, as opposed to the use it or lose approach on older policies.
5. **Reverse Mortgage.** For those who own their home with a fair amount of home equity, this is another potential avenue to supplement some of the monthly LTC costs in a tax efficient fashion. The loan gets repaid when you sell the home

ESTATE AND GIFT EXEMPTIONS

The U.S. estate and gift tax rules provide for a couple of exceptions to the imposition of transfer taxes on any wealth transferred from one U.S. person to another U.S. person, either during life (gifts) or transfers at death (inheritance). These de minimis exceptions are statutory.

The first is called an annual exclusion and only applies to lifetime gifts. Under this rule, each person can transfer up to $16,000 per year (for 2022 gifts) to each of an unlimited number of donees during a calendar year. A spouse may likewise gift up to $16,000 to the same or any other donees. If no single annual gift exceeds the exclusion amount, then there is no need to report any of the gifts that were made for that year. However, if a single gift of a donor exceeds this exclusion by even $1, then all gifts including those below the exclusion amount must be reported on a U.S. Gift Tax Return for the calendar year of the gift. The annual exclusion amount renews for each calendar year, so the maximum annual exclusion gifts can be made to the same donees year after year during your life free from gift tax.

For the donor, any gift made is non income tax deductible. The value of any gift received by a donee from a U.S. person during a calendar year is not taxable income nor is it required to be reported in any way by the donee. While the value of any gift of an asset with unrealized appreciation is not subject to income tax on the donee, if that appreciated asset is later sold by the donee, taxable gain will result to the donee.

In addition to the annual exclusion, U.S. taxpayers also have a statutory "applicable exclusion amount" that can shelter transfers from transfer taxation during life or at death from estate and gift transfer taxes. This exclusion is sometimes also referred to as the taxpayer's unified credit or estate and gift lifetime exemption. But all of these terms refer to a lifetime exemption of $12,060,000 (for gifts/deaths in 2022) per donor. The annual exclusions are always applied first to any gift made for the year. Any gift value in excess of the annual exclusion then starts to reduce the donor's lifetime exemption. In this instance, an annual gift tax return filing is required to report the gifts and the amount of the taxpayer's exemption that was used and remaining. Once the post 1976 cumulative value of gifts start to exceed the value of the donor's lifetime exemption, then gift taxes will start to become payable at a 40% rate.

If any lifetime exemption remains unused at death, then it can be used to shelter the inheritance value as of the date of death. For spouses who die, any unused lifetime exemption from the statutory amount available in the year of the first spouse's death can be claimed by the surviving spouse by making a special election with a tax filing. The surviving spouse can then add the deceased spouse's unused exemption to his/her own for use at the survivor's death. So with properly drafted wills, a married couple today can collectively transfer $24,120,000 ($12,060,000 x 2) free from gift or estate tax to their heirs.

The size of the exemption amount has been in the crosshairs of proposed tax legislation for many years. Progressives who advocate that the wealthy are not paying their fair share of taxes desire a much lower lifetime exemption. The proposals have ranged from $3,500,000 per person to one-half of the current exemption amount. Since the estate tax only accounts for less than 2% of the federal tax revenues, proposed changes generally get dropped from any final legislation, at least in the last decade. But ambitious spending plans of the current administration could put these proposals into the discussion as a means of helping pay for the new programs.

Today, both the annual exclusion and applicable exclusion amounts are indexed annually for inflation. For the past 15 years, inflation has been very low and accordingly, so have the annual inflation adjustments. However, inflation has surged in 2021 and the exemption amounts are likewise seeing a fairly large increase for 2022.

PORTFOLIO TAX DRAG

"Tax drag" is a term applied to the annual reduction in a taxable investment's return that is lost to annual income taxes. According to a recent BlackRock study, roughly one out of every three dollars invested in U.S. mutual funds was held in a taxable account at the end of 2020, representing $7.6 trillion in assets. The study further notes that taxes on distributions shaved 1.69 percentage points off the average annual performance of alpha-seeking (actively managed) U.S. Large-Cap Blend mutual funds for taxable investors in the decade that ended in 2020. That figure is nearly double the 0.87 percentage point average management expense ratio charged by those same funds in 2020. But while many Americans hold funds in investment accounts that are subject to taxes, tax efficiency is not well recognized as a prime investment consideration by many investors. In fact, many investors give about as much consideration to the tax drag cost of their investments as they do to that extra cable TV channel they pay for but never watch.

Consider this numbers example. A hypothetical taxable mutual fund investment of $1,000,000 earning 12% per year for 10 years grows to $3,100,000 on a pre- tax basis. But the income tax drag over the 10 years is a whopping $462,000, leaving roughly $2,640,000 after taxes. This is a 1.79% tax cost or drag on the portfolio's gross 12% return.

You cannot totally eliminate tax drag in taxable accounts, but you can take steps to reduce it. In the process of investing for retirement or financial independence, time is your friend. Very modest increases in net after tax annual returns over long periods of time derived from reducing tax drag can significantly affect the accumulation value you experience.

While most investors are generally sensitive to the annual management fee of their investment funds, they tend to overlook that the potential effects of taxes can be much more detrimental to portfolio returns than fees. The key is to focus not only on the tip of the investment fund iceberg but also what lies beneath the surface.

So what are the various income taxes that drag down a fund's gross annual returns? Keeping in mind that we are exploring this subject only in the context of taxable investments, several taxes may apply to the investment income produced by the fund during the year. Those taxes include taxes on dividends, taxes on capital gains, alternative minimum tax and additional taxes on net investment income above certain taxpayer total income levels determined by tax filing status. For example, certain mutual fund distributions are classified as qualified dividends or long term capital gains from sales of appreciated securities during the year. For 2021, the maximum combined tax rate for these distributions is up to 23.8% for federal tax. Distributions that are classified as short term capital gains, interest or non-qualified dividends are taxed as ordinary income for a combined rate of up to 43.4% for federal tax. State income taxes may also apply depending on the state of tax residence of the investor.

The tax rules applicable to a particular investment fund's structure, such as a mutual fund, exchange traded fund (ETF) or separately managed account (SMA) will impact the level of tax drag. As a result of the type of investment vehicle you are invested in, you may find varying levels of your ability to control the tax consequences resulting from that fund structure. So the primary variables to pay attention to are the investment fund's structure and the trading activity level of the manager of the fund. In our quarterly newsletter for the first quarter of 2022, we will examine a number of strategies and actions that investors and their advisors can take to reduce tax drag.

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We seek to bring wealth planning best practices and a wide range of non-proprietary solutions to our clients. We also conduct our own research and diligence on world markets and investment alternatives.

For further information, please contact your investment representative or one of our wealth planning specialists:

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