Berman Capital Management & Research
Ted C. Berman, AAMS®
Tim J. Mason, Michael J. Basso, CFP
3077 W. Jefferson Street
Suite 200
Joliet, IL 60435
815-725-8300
tedberman@afpadvisor.com
www.bermancapitalmanagement.com

Happy Thanksgiving Everyone!

Terri, Brenda, Carol, Tim, Mike, Norma & Ted

November 2017

Examining the Taxpaying Population: Where Do You Fit In?

Future of the Federal Estate Tax

Is the Social Security Administration still mailing Social Security Statements?

How do economists measure inflation, and why does it matter to investors?

Berman Capital Management & Research
Serving Investors Since 1984

Berman Capital Management News
Financial & Investment Insights

What You Can Do with a Will

A will is often the cornerstone of an estate plan. Here are five things you can do with a will.

Distribute property as you wish

Wills enable you to leave your property at your death to a surviving spouse, a child, other relatives, friends, a trust, a charity, or anyone you choose. There are some limits, however, on how you can distribute property using a will. For instance, your spouse may have certain rights with respect to your property, regardless of the provisions of your will.

Transfers through your will take the form of specific bequests (e.g., an heirloom, jewelry, furniture, or cash), general bequests (e.g., a percentage of your property), or a residuary bequest of what's left after your other transfers. It is generally a good practice to name backup beneficiaries just in case they are needed.

Note that certain property is not transferred by a will. For example, property you hold in joint tenancy or tenancy by the entirety passes to the surviving joint owner(s) at your death. Also, certain property in which you have already named a beneficiary passes to the beneficiary (e.g., life insurance, pension plans, IRAs).

Nominate a guardian for your minor children

In many states, a will is your only means of stating who you want to act as legal guardian for your minor children if you die. You can name a personal guardian, who takes personal custody of the children, and a property guardian, who manages the children's assets. This can be the same person or different people. The probate court has final approval, but courts will usually approve your choice of guardian unless there are compelling reasons not to.

Nominate an executor

A will allows you to designate a person as your executor to act as your legal representative after your death. An executor carries out many estate settlement tasks, including locating your will, collecting your assets, paying legitimate creditor claims, paying any taxes owed by your estate, and distributing any remaining assets to your beneficiaries. As with naming a guardian, the probate court has final approval but will usually approve whomever you nominate.

Specify how to pay estate taxes and other expenses

The way in which estate taxes and other expenses are divided among your heirs is generally determined by state law unless you direct otherwise in your will. To ensure that the specific bequests you make to your beneficiaries are not reduced by taxes and other expenses, you can provide in your will that these costs be paid from your residuary estate. Or, you can specify which assets should be used or sold to pay these costs.

Create a testamentary trust or fund a living trust

You can create a trust in your will, known as a testamentary trust, that comes into being when your will is probated. Your will sets out the terms of the trust, such as who the trustee is, who the beneficiaries are, how the trust is funded, how the distributions should be made, and when the trust terminates. This can be especially important if you have a spouse or minor children who are unable to manage assets or property themselves.

A living trust is a trust that you create during your lifetime. If you have a living trust, your will can transfer any assets that were not transferred to the trust while you were alive. This is known as a pourover will because the will "pours over" your estate to your living trust.

Caveat

Generally, a will is a written document that must be executed with appropriate formalities. These may include, for example, signing the document in front of at least two witnesses. Though it is not a legal requirement, a will should generally be drafted by an attorney.

There may be costs or expenses involved with the creation of a will or trust, the probate of a will, and the operation of a trust.

Sources for data: IRS Statistics of Income Bulletins, Spring 2017 and Summer 2017, Washington, D.C., irs.gov/statistics

What is adjusted gross income (AGI)?

Adjusted gross income, or AGI, is basically total income less adjustments for certain items, such as deductible contributions made to an IRA, alimony paid, and qualified student loan interest paid.

Examining the Taxpaying Population: Where Do You Fit In?

Every quarter, the Statistics of Income Division of the Internal Revenue Service (IRS) publishes financial statistics obtained from tax and information returns that have been filed with the federal government. Recently published reports reflect data gleaned from 2014 individual federal income tax returns. These reports offer a snapshot of how the U.S. population breaks down as taxpayers.

The big picture

For tax year 2014, U.S. taxpayers filed roughly 139.6 million individual income tax returns.[1] Total adjusted gross income reported on these tax returns was $9.71 trillion, resulting in a total income tax of $1.37 trillion. That works out to an overall average tax rate of 14.16% for all returns filed — the highest total average rate in the 10-year period represented by the statistical report.

If your 2014 AGI was $38,173 or more, you were in the top 50% of all federal income tax filers based on AGI. This group accounted for 88.7% of all AGI reported and paid 97.3% of total federal income tax for the year.

A look at the top

How much AGI did it take to make the top 10% of all individual filers? Probably not as much as you might think. If your AGI was $133,445 or greater, you would have been one of the almost 14 million filers making up the top 10%. This group reported about $4.58 trillion in AGI (more than 47% of all AGI reported) and accounted for about 70.9% of total individual income tax for the year.

To make the top 5%, you would have needed $188,996 or more in AGI. You would have been among approximately 7 million filers who reported almost $3.5 trillion in total AGI and accounted for about 60% of total income taxes paid.

It's also worth noting that the top 3% of all 2014 individual income tax returns based on AGI accounted for 52.9% of total income tax paid for the year.

The very, very top

For the 2014 tax year, 1.4 million returns had an AGI of $465,626 or more. These taxpayers make up the top 1% of filers, reporting almost $2 trillion in total AGI and responsible for just under a 40% share of the total tax haul.

The 1,396 income tax returns that showed $56,981,718 or more in AGI make up the top 0.001% (that's the top one-thousandth of 1%) of 2014 filers. These filers together reported over $207 billion in AGI and paid over 3.6% of taxes.

Not all high-income returns showed tax

Of the 6.2 million income tax returns filed for 2014 with an AGI of $200,000 or more, 10,905 showed no U.S. income tax liability (the number drops to 3,927 if you eliminate returns filed by individuals who were responsible for income taxes to foreign governments and had no U.S. income tax because of a credit for such taxes paid).

Why did these high-income returns show no U.S. tax liability? The IRS report noted that these returns show no tax for a variety of reasons, including tax credits and deductions, most notably miscellaneous deductions and deductions for charitable contributions, medical and dental expenses, and investment interest expenses. A significant secondary factor was the deduction for taxes paid.

Average tax rates

Dividing total tax paid by total AGI yields the following average federal income tax rates for the 2014 tax year:

Top Filers (by Percentile)	AGI Threshold	Average Tax Rate
0.001%	$56,981,718	24.01%
0.01%	$11,407,987	25.92%
0.1%	$2,136,762	27.67%
1%	$465,626	27.16%
5%	$188,996	23.61%
10%	$133,445	21.25%
20%	$90,606	18.64%
30%	$66,868	17.19%
40%	$50,083	16.24%
50%	$38,173	15.52%

[1] Excludes returns filed by dependents; based on final estimates for tax year 2014 reported in Spring 2017 Statistics of Income Bulletin

Berman Capital Management & Research
Serving Investors Since 1984

Future of the Federal Estate Tax

The federal estate tax has been enacted or repealed a number of times over the years, while undergoing many changes. Tax reform, including possible repeal of the estate tax, is back in the spotlight once again.

[1] 2015 Field Guide to Estate Planning, Business Planning & Employee Benefits

While no one can predict the future, the possibility of tax reform is once again in the spotlight. If it occurs, it may very well include repeal of the federal estate tax and related changes to the federal gift tax, the federal generation-skipping transfer (GST) tax, and the federal income tax basis rules.

History of the federal estate tax

In general, an estate tax is a tax on property a person owns at death. In one form or another, a federal estate tax has been enacted or repealed a number of times since 1797.[1]

Estate tax enacted	Estate tax repealed
1797	1802
1862	1872
1894	1902
1916	2010*
2011*	

**For 2010, the estate tax was repealed, but later retroactive legislation provided that an estate could elect to be subject to estate tax in return for a stepped-up (or stepped-down) income tax basis for most property. The estate tax was extended in 2011, with some changes.*

The estate tax has undergone many changes over the years, including the addition of a federal gift tax and a federal GST tax during modern times. A gift tax is a tax on gifts a person makes while alive. A GST tax is a tax on transfers to persons who are two or more generations younger than the transferor. In recent years, property owned at death has generally received an income tax basis stepped up (or down) to fair market value at death.

During the 2000s, the estate, gift, and GST tax rates were substantially reduced, and the gift and estate tax lifetime exclusion and the GST tax exemption were substantially increased. The estate tax and the GST tax, but not the gift tax, were scheduled for repeal in 2010 (although certain sunset provisions would bring them back unless Congress acted), but legislation extended the estate tax and the GST tax in 2011. (For 2010, the estate tax ended up being optional and the GST tax rate was 0%.) The gift and estate tax lifetime exclusion and the GST tax exemption were increased to $5,000,000 and indexed for inflation in later years. For 2013, the top estate, gift, and GST tax rate was increased to 40%, and the extension and modifications were made "permanent."

2017 Estate Planning Key Numbers	
Annual gift tax exclusion	$14,000
Gift tax and estate tax basic exclusion amount	$5,490,000
Noncitizen spouse annual gift tax exclusion	$149,000
Generation-skipping transfer (GST) tax exemption	$5,490,000
Top gift, estate, and GST tax rate	40%

Federal estate tax

Repeal of the estate tax seems possible once again. If repeal occurs, it could be immediate or gradual as during the 2000s. Would it be subject to a sunset provision, so that the estate tax would return at a later time? All of this may depend on congressional rules on the legislative process, other legislative priorities, and the effect the legislation would have on the budget and the national debt.

Federal gift tax

If the estate tax is repealed, the gift tax may also be repealed. However, it is possible that the gift tax would be retained as a backstop to the income tax (as in 2010). To some extent, the gift tax reduces the ability of individuals to transfer property back and forth in order to reduce or avoid income taxes.

Federal GST tax

If the estate tax is repealed, the GST tax would probably be repealed (as in 2010). If the gift tax is not repealed, it is possible that the lifetime GST tax provisions would be retained, but the GST tax provisions at death repealed.

Federal income tax basis

If the estate tax is repealed, it is possible that the general income tax basis step-up (or step-down) to fair market value at death would be changed to a carryover basis (i.e., the decedent's basis before death carries over to the person who inherits the property). In 2010, a modified carryover basis (a limited amount of property could receive a stepped-up basis) applied unless the estate elected to be subject to estate tax. It is also possible that a Canadian-style capital gain tax at death could be adopted in return for a stepped-up basis for the property.

Berman Capital Management & Research
Ted C. Berman, AAMS®
Tim J. Mason, Michael J. Basso, CFP
3077 W. Jefferson Street
Suite 200
Joliet, IL 60435
815-725-8300
tedberman@afpadvisor.com
www.bermancapitalmanagement.com

Is the Social Security Administration still mailing Social Security Statements?

Your Social Security Statement provides important information about your Social Security record and future benefits. For several years, the Social Security Administration (SSA) mailed these statements every five years to people starting at age 25, but due to budgetary concerns, the SSA has stopped mailing Social Security Statements to individuals under age 60.

Workers age 60 and over who aren't receiving Social Security benefits will still receive paper statements in the mail, unless they opt to sign up for online statements instead. If you're age 60 or older, you should receive your statement every year, about three months before your birthday. The SSA will mail statements upon request to individuals under age 60.

However, the quickest way to get a copy of your Social Security Statement is to sign up for a *my* Social Security account at the SSA website, ssa.gov. Once you've signed up, you'll have immediate access to your statement, which you can view, download, or print. Statement information generally includes a projection of your retirement benefits at age 62, at full retirement age (66 to 67), and at age 70; projections of disability and survivor benefits; a detailed record of your earnings; and other information about the Social Security program.

The SSA has recently begun using a two-step identification method to help protect *my* Social Security accounts from unauthorized use and potential identity fraud. If you've never registered for an online account or haven't attempted to log in to yours since this change, you will be prompted to add either your cell phone or email address as a second identification method. Every time you enter your account username and password, you will then be prompted to request a unique security code via the identification method you've chosen, and you need to enter that code to complete the log-in process.

How do economists measure inflation, and why does it matter to investors?

The Federal Open Market Committee (FOMC) adjusts interest rates to help keep inflation near a 2% target. The FOMC's preferred measure of inflation is the Price Index for Personal Consumption Expenditures (PCE), primarily because it covers a broad range of prices and picks up shifts in consumer behavior. The Fed also focuses on core inflation measures, which strip out volatile food and energy categories that are less likely to respond to monetary policy.

The typical American might be more familiar with the Consumer Price Index (CPI), which was the Fed's favorite inflation gauge until 2012. The Consumer Price Index for All Urban Consumers (CPI-U) is used to determine cost-of-living adjustments for federal income taxes and Social Security.

The CPI only measures the prices that consumers actually pay for a fixed basket of goods, whereas the PCE tracks the prices of everything that is consumed, regardless of who pays. For example, the CPI includes a patient's out-of-pocket costs for a doctor's visit, while the PCE considers the total charge billed to insurance companies, the government, and the patient.

The PCE methodology uses current and past expenditures to adjust category weights, capturing consumers' tendency to substitute less expensive goods for more expensive items. The weighting of CPI categories is only adjusted every two years, so the index does not respond quickly to changes in consumer spending habits, but it provides a good comparison of prices over time.

According to the CPI, inflation rose 2.1% in 2016 — right in line with the 20-year average of 2.13%.[1] This level of inflation may not be a big strain on the family budget, but even moderate inflation can have a negative impact on the purchasing power of fixed-income investments. For example, a hypothetical investment earning 5% annually would have a "real return" of only 3% during a period of 2% annual inflation.

Of course, if inflation picks up speed, it could become a more pressing concern for consumers and investors.

[1] U.S. Bureau of Labor Statistics, 2017 (data through December 2016)

Berman Capital Management & Research
Serving Investors Since 1984