DCA BRIEFING: Inflation Lemonade

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INFLATION LEMONADE

Needless to say, 2022 was a very difficult year for the economy, to say the least. From the stock market (S&P 500) having its worst returns since 2008, to the bond market (Barclays Aggregate Bond Index) having its worst returns EVER, to inflation rates reaching the highest levels we have seen since the 1980s, to skyrocketing interest rates, finding a financial silver lining can be a challenging task. But as discouraging as this task may seem, the combination of adverse events we faced in the prior year provided some unique opportunities to turn lemons into lemonade.

The depressed financial markets have provided the opportunity to take more significant advantage of the benefits of various tax planning strategies such as tax loss harvesting and Roth Conversions. The meteoric rise of interest rates has once again provided investors the opportunity to allocate capital to ultra-short fixed-income investments with yields not seen in 20 years. Investments into ultra-short high-quality fixed income help provide both liquidity coverage and the ability to manage the exceptionally high risk and volatility environment we currently face. And inflation, which has perhaps had the greatest financial impact and been the greatest financial concern for many people, has provided some of the best financial planning opportunities we have presented.

The stubbornly high inflation we have faced has brought about record adjustments to help ease the burden of rising costs. Social Security recipients will receive their first checks this month with the record-high 8.7% 2023 Cost-of-Living adjustment. The IRS 2023 annual inflation adjustments have increased a number of tax provisions, including the standard deduction, marginal tax rates, various contribution rates, and gift and estate exclusions which provide one of the greatest potential opportunities that could be most impactful to the wealthy.

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INFLATION LEMONADE (CONT,)

The Tax Cuts and Jobs Act of 2017 doubled the estate tax exclusion amount and, after annual adjustments for inflation, was up to $12,060,000 in 2022. With the 2023 inflation adjustment, that number has increased by over 7% up to $12,920,000. And when factoring in the spousal exemption, a married couple can pass on to their heirs almost $26,000,000 tax-free. The caveat to this silver lining is that the act that created this substantial increase in the estate and gift tax exclusion is set to sundown at the end of 2025, which means that without further legislative intervention, there is a limited amount of time to turn these lemons into lemonade until the exclusion reverts back to its inflation-adjusted $5,000,000 level.

With only a few more years of certainty remaining, strategic planning and the use of various wealth transfer and gifting techniques (e.g., Trusts, Roth Conversions, strategic coordination of lifetime gift and estate exclusion between spouses) is becoming more critical than it has have ever been, especially for those whose wealth may boarder the edges of the current exclusion amount. While legislation may very well pass that keeps the exclusion at elevated levels, the risk associated with the sundown of the Tax Cuts and Jobs Act and reversing the exclusion amount comes at a very high cost.

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