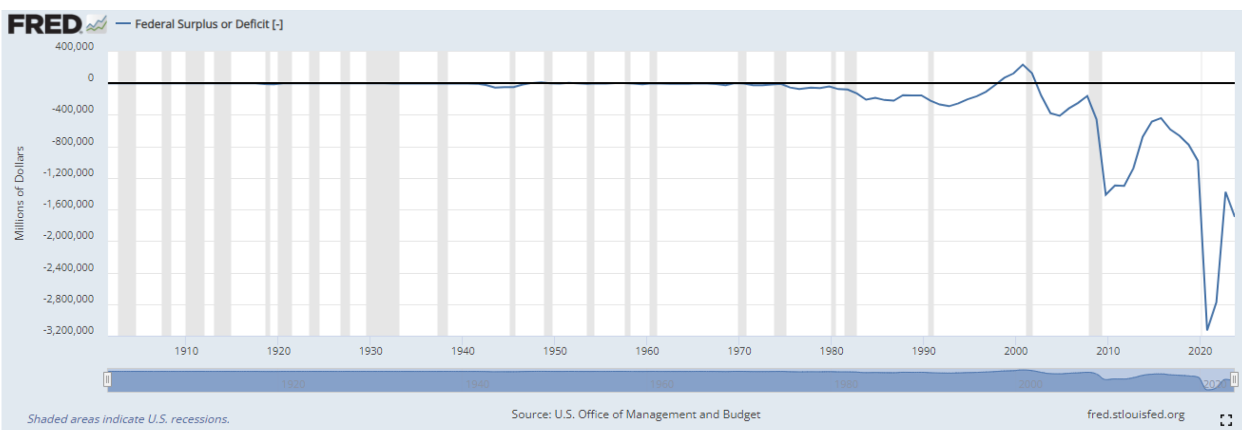
Taxes!!!

"Isn't it appropriate that the month of the tax begins with April Fool's Day and ends with cries of May Day!" – Robert Knauerhase

This quarter we want to touch on everyone's favorite subject – taxes! Before you consider closing this commentary, hear us out. We aim to provide some historical context, share thoughts and ideas, and address the impact of taxes on your investment portfolio. In particular, we'll explore the common belief that higher taxes lead to lower investment returns. While taxes can affect your budget and financial planning, our focus here is on understanding the long-term implications for your investments.

As financial planners, our role is not to prepare tax returns but to help you think strategically about your tax situation. Tax advice is highly individualized; there is no "one-size-fits-all" solution. However, the better we understand your goals and financial picture, the better we can help you develop a plan to reduce your lifetime tax burden. One common mistake we see is focusing only on minimizing taxes owed in the current year. Our goal is to strike a balance: sometimes it makes sense to pay a bit more tax today to achieve greater long-term savings. Ultimately, it's about managing your taxes effectively so that you pay the least amount of taxes over a multi-year period.

Many clients express concern about potential tax increases and their impact on investment portfolios. This fear is often driven by worries over the $35 trillion national debt. Historically, the federal budget has varied significantly, as shown in the graph below.



From the 1900s to the mid-1970s, federal deficits were minimal. In the 1980s, as top marginal tax rates were cut, deficits began to increase, a trend that has continued. Notably, both political parties have contributed to increased deficit spending, as seen in the percentage increase in national debt during various presidential terms:

- Ronald Reagan (1981-1989): 186.36%
- George H.W. Bush (1989-1993): 54.39%
- Bill Clinton (1993-2001): 31.64%
- George W. Bush (2001-2009): 105.08%
- Barack Obama (2009-2017): 69.98%
- Donald Trump (2017-2021): 40.43%
- Joe Biden (as of 8/8/24): 23.42%

Source: (https://www.usatoday.com/money/blueprint/banking/national-debt-by-president/)

As Appendix A shows, tax rates in the United States were much higher for most of the last century. Since the 1980s, lower tax rates have coincided with significant deficit spending. While lower taxes are beneficial to individuals in the short term, they contribute to uncertainty regarding the impact of rising national debt.

If tax rates were to increase to address the deficit, what would that mean for the stock market and your portfolio? Historical data offers some insight. As illustrated in Appendix A, the top marginal tax rate in the United States has remained consistent for a decade three separate times. The top rate was 91% from 1954-1963, 70% from 1971-1980, and 35% from 2003-2012. During these periods, S&P 500 annualized returns were:

- 1954-1963: 11.31%
- 1971-1980: 7.06%
- 2003-2012: 4.39%

Source: https://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/histretSP.html

This data suggests that there is no consistent correlation between higher tax rates and lower market returns. In fact, as we discussed in our Q1 2024 commentary, demographic trends are often a more significant driver of market performance than tax rates. Strong market growth in the 1950s and 1960s, for instance, was supported by a rapidly growing population, despite high tax rates.

As financial advisors, our goal is to help you craft a financial plan that can withstand various unpredictable outcomes. In 1980, there were 16 different tax brackets for married couples filing jointly, and in 1955, there were 24. Today, we have fewer than 10. If tax rates increase, it's possible that the number of tax brackets may also increase, making proactive tax planning even more important.

While we can't control who gets elected or what tax policies are enacted, we can help you create a resilient financial plan. We can also help you understand how proposed policies may impact your specific situation. If you have questions, or if a plan update or tax projection might be helpful, please reach out to your relationship manager.

Appendix A: Top Marginal Tax Rates

Historical Highest Marginal Income Tax Rates

Year	Top Marginal Rate	Year	Top Marginal Rate	Year	Top Marginal Rate	Year	Top Marginal Rate
1913	7.00%	1948	82.13%	1983	50.00%	2018	37.00%
1914	7.00%	1949	82.13%	1984	50.00%	2019	37.00%
1915	7.00%	1950	84.36%	1985	50.00%	2020	37.00%
1916	15.00%	1951	91.00%	1986	50.00%	2021	37.00%
1917	67.00%	1952	92.00%	1987	38.50%	2022	37.00%
1918	77.00%	1953	92.00%	1988	28.00%	2023	37.00%
1919	73.00%	1954	91.00%	1989	28.00%		
1920	73.00%	1955	91.00%	1990	28.00%		
1921	73.00%	1956	91.00%	1991	31.00%		
1922	58.00%	1957	91.00%	1992	31.00%		
1923	43.50%	1958	91.00%	1993	39.60%		
1924	46.00%	1959	91.00%	1994	39.60%		
1925	25.00%	1960	91.00%	1995	39.60%		
1926	25.00%	1961	91.00%	1996	39.60%		
1927	25.00%	1962	91.00%	1997	39.60%		
1928	25.00%	1963	91.00%	1998	39.60%		
1929	24.00%	1964	77.00%	1999	39.60%		
1930	25.00%	1965	70.00%	2000	39.60%		
1931	25.00%	1966	70.00%	2001	39.10%		
1932	63.00%	1967	70.00%	2002	38.60%		
1933	63.00%	1968	75.25%	2003	35.00%		
1934	63.00%	1969	77.00%	2004	35.00%		
1935	63.00%	1970	71.75%	2005	35.00%		
1936	79.00%	1971	70.00%	2006	35.00%		
1937	79.00%	1972	70.00%	2007	35.00%		
1938	79.00%	1973	70.00%	2008	35.00%		
1939	79.00%	1974	70.00%	2009	35.00%		
1940	81.10%	1975	70.00%	2010	35.00%		
1941	81.00%	1976	70.00%	2011	35.00%		
1942	88.00%	1977	70.00%	2012	35.00%		
1943	88.00%	1978	70.00%	2013	39.60%		
1944	94.00%	1979	70.00%	2014	39.60%		
1945	94.00%	1980	70.00%	2015	39.60%		
1946	86.45%	1981	69.13%	2016	39.60%		
1947	86.45%	1982	50.00%	2017	39.60%		

Notes: This table contains a number of simplifications and ignores a number of factors, such as the amount of income or types of income subject to the top rates, or the value of standard and itemized deductions.

Source: Tax Policy Center