Ep103: Tax Planning Strategies and Updates with John Nersesian of PIMCO

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PATTI BRENNAN: Hi, everybody. Welcome to "The Patti Brennan Show." Whether you have $20 or $20 million, this show is for those of you who want to protect, grow, and use your assets to live your very best lives.

Joining me again is John Nersesian. He is the advisors professor. Literally, he is the advisors professor. I am so honored that he has joined us in our podcast studio today. John teaches professionals like me in the advanced education, advanced wealth management strategies. We're going to be talking about that today. A lot of that. A lot of ideas.

For those of you who may not have listened to our previous podcast, I got to tell you, shut this one off and go to that one.

In that podcast, John and I talked about the tricks that our brains play on us, and have us do things that really sabotage the outcomes that we're looking to achieve. Most of the time, we don't even realize that that's happening. It's fascinating. John's done a lot of work in that area, in a lot of areas.

Wait till you hear him again today. He's brilliant, absolutely brilliant. He teaches at the University of Chicago and Yale, in a program called the Certified Private Wealth Advisor program, CPWA certification program. This is for advanced planning strategies.

Those of us who have been in the industry for a while, we think we might know a lot, but there's still always a lot more that we need to know.

I was talking with John, about the podcast today. One thing led to another and he started talking. I was like, John, I got to take that. That sounds phenomenal. It's so important for us to stay ahead, to understand the tactics and strategies that can be useful in the lives of the people that we serve.

John, welcome back. Thank you so much for joining us again.

JOHN NERSESIAN: It's my pleasure. That's what makes you such a great advisor, the fact that you know a lot, obviously, and are so helpful to your clients, but you're always looking to learn more. I think that desire to learn and to be more helpful to other people is an admirable quality.

PATTI: The longer I do this, the more I realize the less I know.

JOHN: I feel the same way.

PATTI: It just is amazing all the things, and just in the conversations that I've had with you over the past few weeks, it's like wow. It is a humbling industry that is for sure.

JOHN: Doesn't that make it fun? I mean, if we knew the answers to every endeavor to every conversation that we were having, if it was the same thing over and over again. Did you ever see the movie with Andie MacDowell and Bill Murray, "Groundhog Day" I think it was called.

PATTI: Oh yeah.

JOHN: That guy wakes up and every day is the same day. It's a pretty boring existence. The fact that our industry is evolving, the fact that there are more skills for us to develop and share with others, I think that's what makes it challenging and fun.

PATTI: It is fun. I also find, at least for me, for example, in my quarter letters, I've written a letter to our clients every 90 days for over 30 years.

JOHN: Wow.

PATTI: It's interesting when I go to think about what I want to write about. I usually write about stuff that I don't know. For example, the Russian-Ukrainian conflict, and I never realized where it all came from. What could it have been to make this person, Vladimir Putin, invade another country? What's the history behind that? What one said, if you don't know something, write a book about it.

JOHN: There you go.

PATTI: In my case I write a letter about it.

JOHN: I love it.

PATTI: I'll also tell you that thankfully, with this podcast program, I think that's one of the greatest benefits of this podcast program. For those of you who are advisors out there, and I know that there are a lot of you who are listening and tune into these programs.

For me, at least, and for my firm, what I found is that the podcast per se, yes it's great to share this information with clients and with the public, but it's also really important for my team. I was just telling them this morning – I didn't plan on sharing this – but I'm renaming this team, and these guys are all my key mates. It's key-financial, they're my key mates.

JOHN: Cute.

PATTI: We are key to each other.

JOHN: And to your clients.

PATTI: And our clients, absolutely. What's interesting is that the podcast program has become another avenue for us to learn. For example, when COVID happened, we talked a lot about COVID. I do have a medical background as you might know I used to be an ICU nurse. I didn't know the difference between a virus and a bacteria. What is the difference?

JOHN: Medically.

PATTI: Exactly. Is that relevant to a person's money? Mm, not really, but maybe a little indirectly. It helped us to make better decisions during that period of time.

JOHN: I love it, just the fact that you wanted to learn about I think is really the key concept in this discussion, so stop and think about this. What we do for a living is we teach people, right? We impart advice, we teach them. I teach advisors, you teach the investors that trust you with their capital. In order to be a good teacher, the first thing you have to be is a good student.

PATTI: Yes.

JOHN: We have to learn first. We acquire the knowledge and the competencies required so that we can then share them with others. That desire to learn, that's what gets you an eye up each and every morning.

PATTI: Absolutely. Johnson, I'm going to learn more from that brilliance of yours about the tax laws. Let's rewind to last year, you and I were frantically working the end of last year to get ahead of what was potentially a pretty draconian new tax law. Why do you think that didn't pass?

JOHN: Nothing happened. That was the biggest surprise. If you and I were betting last year, you and I would not have been alone, by the way. A lot of folks were assuming, or counting on some major tax reform coming. Stop and think about the evolution.

It started with Biden during his campaign, talking about tax reform, about making it fairer and more balanced. It then evolved into the "Green Book" publication back in April. We saw things about how capital gain rates going to ordinary for people over a million dollars, and maybe the loss of step up and basis, and then even the submission to House Ways and Means in November.

All three stages along the way, you and I were convinced that tax reform was coming. The advice I gave people back then was, "Wait a minute, I get it. We're concerned about this. It has major implications for our financial decisions. But first things first, learn about what's being discussed. Go ahead and plan for potential changes, but pause before you do anything."

We had a suspicion that it may not evolve, it may not actually come to pass. A lot of what we were dealing with were the results of TCJA back in 2017, the lowering of ordinary rates from 39.6 to 37, the idea that capital gains were stuck at 20, plus your 3.8 percent NII, the increase in the estate tax exemption amount.

The good news is you gave great counsel to your clients. You said, "Let's learn about this, let's prepare for it, but let's not do anything retroactively until we really understand what's going to pass." Of course, nothing did.

PATTI: It's so interesting, because that retroactive, that word, boy, did that stop a lot of people dead in their tracks. The fact that they were looking at, the higher capital gain rate retroactive to, I guess it was September. "What are we going to do now? It's October, it's too late for us to do anything."

JOHN: You can't do anything about it.

PATTI: It's interesting, because I will tell you, and I admit, I went out and bought a software program ...that would run an analysis of, "Does it make sense to go ahead and sell some of these assets, go ahead and pay the capital gains tax at the theoretically lower rate to avoid ordinary income rates later on?"

JOHN: I hope you get to the seat so you can take that back to the store. [laughs]

PATTI: I learned something though, we ran the numbers. It really came down to time. It came down to what your holding period is. That's all that matters. Just as we talked about before, it is very personal. Some people might be paying that 20 percent plus the 3.8 percent today, but maybe they're not going to be in that bracket 10 years from today, when they retire.

Why would we sell something when they're not going to be subjected to it anyway? It was very personal. It's so interesting, because at the end of the day, it makes me realize how important having good judgment, just exercising good judgment, that's looking out for the best interests of that family, based on the information that we have today, which can change in a moment's notice.

JOHN: I love it. I love it. Taxes are an important part of that process that you bring to your clients, of course.

This comprehensive Wealth Management Program, looking at your obviously what's important to you in your life, your financial security, your retirement resources, your ability to educate your kids to send them to Georgetown or Lehigh, and all the important things we do, taxes are a part of that equation.

I know that some advisors are somewhat reluctant to talk about taxes. "Hold on, John, I'm not a CPA. I'm not a tax attorney. I don't want to get myself into trouble by talking about taxes. I'm opening up some liability issues here."

Well, I have three rhetorical questions to ask, "Do you provide advice to your clients on the recognition of gains and losses?" Of course we do. "You provide advice to your clients on their charitable giving, what they give, whom they give to and how much and when? Do you provide advice to your clients on retirement accounts, contributions to their retirement accounts or distributions?"

You can tell from my simplistic examples, so much of what we do on a day-to-day basis has a tax impact on the outcomes our clients achieve. We have to be tax-aware. We have to include a tax understanding in the financial planning work that we do for clients more broadly.

PATTI: Absolutely. I have no problem, whatsoever, talking about taxes. In fact, every year, we get every client's tax return after the fact, and we review it.

JOHN: Oh, I love it.

PATTI: What I've learned over time is that every once in a while, we catch mistakes. They're human errors. No big deal. Just file an amended return or whatever. We find opportunities that we didn't know were going to exist in this calendar year. To me, that's the whole idea, is to be proactive.

JOHN: I was just going to use the word proactive, because the common refrain I hear from many investors is, "Well, wait a minute, Patti. My CPA is taking care of that. They're going to file my tax return in April. They're going to make sure I get all the deductions I'm entitled to and lower my tax bill through the filing process."

Well, hold on a second. Next April, it's too late to do anything. This is retroactive accounting that's looking backward as to what already occurred. It's not the proactive planning that you're speaking of.

I think that is so valuable to have conversations with families today about the steps they can take, not that the tax outcome is necessarily the most important objective. It is a component of the financial planning process. Being on top of it, being aware of it, taking advantage of the unique opportunities that are before you is important.

Think about this. We try our best to allocate capital. Should I overweight international stocks versus domestic stocks? Should I overweight small cap versus large cap? We try our best to try to allocate capital in the most productive fashion, but the truth is we can't control it.

Taxes are something that we can control. We know what the rules are. We know that when we contribute to an HSA that money comes out tax-free. We know that we put money in 529 plans, that we're able to save money for college in a tax-efficient manner.

There are knowns within the tax code that allow the investor to enjoy more probable benefits that are maybe accompanying or available through traditional investment advice.

PATTI: It sure is the case and also to understand the unintended consequences of certain actions. For example, we talked about this before. We run the numbers. We're not going to guess we're running the numbers. They are projections, cash flow, income tax, etc.

Especially, as a person is approaching or in retirement, a lot of times, they'll go from a very high tax bracket, and it plummets. All of a sudden, they go from 37 percent. If we've done our job right, hopefully, in the three years before retirement, their tax bracket is going to go down to 12 percent.

Here's a tactical idea for everybody listening. If that happens, what can you do at a 12 percent tax bracket? How about…?

JOHN: Roth conversions.

PATTI: Roth conversions, love it. Take just enough of a Roth conversion to get you up to the tippy top of the 12 percent tax bracket. However, be careful, because a lot of people who retire early may be on the ACA. That's also known as Obamacare.

By the way, if you're in a 12 percent tax bracket, you're probably getting a juicy subsidy. Now that subsidy is something that you don't want to have to give back. As we think about the tax planning – and these are great ideas – Roth conversions are, for many people, a homerun – got to be careful that we're not creating an unintended consequence where somebody's going to lose that $1,000 a month.

JOHN: You know, it's great that you've identified that because sometimes we make these decisions on the surface, "Oh, I'm going to go ahead and do this conversion, or accelerate income, or whatever the strategy might be," but the tax code has ripple effects throughout.

That decision to either lower my taxable income or increase my taxable income may have ramifications that are not immediately available, items that occur below the surface, so to speak.

PATTI: Yeah, exactly. Even from an investment perspective, for those people that you may be talking to, they're managing an investment portfolio.

If they know that the client is going to be in a 12 percent tax bracket, for example, if that's me, if it's November or December and they've got a big capital gain, and I know they're going to be in a 12 percent tax bracket next year, I think I'm going to procrastinate a little bit.

We don't know what's going to happen with markets. Why not sell that asset or the portion of it January 2nd. Guess what. They don't pay any tax on it up to a certain amount.

JOHN: My son just graduated from Northwestern. He works up in Chicago for the Chicago White Sox. He graduated in June of last year. He started his working career. Of course, being a relatively new employee, his income wasn't very high. He only had six months of earnings.

My wife and I, of course, wanted to buy him a graduation gift. We decided to buy him a little Audi Q3. We thought about liquidating assets and then using the money to buy this new car, but we took the advice that you just provided.

"Wait a minute. Our son is in a low bracket, in fact, a zero-capital gain bracket. We can transfer that low-basis property from us to him, have him sell it with zero taxes, acquired the same car, made the same gift that we wanted to make but did so in a tax-efficient manner."

These are the opportunities that so many people miss but that they can receive benefit from if they work with great people like you.

PATTI: That's a great idea. That's called income shifting. It's a great idea. You and I talked with a lot of people during the year. Very wealthy people do things like family limited partnerships to create that same kind of income shift.

OK, let's go back. The tax law, the Build Back Better Plan did not go through.

JOHN: Did not.

PATTI: I'm curious, what do you think was the headwind? Is it because there was a change in any tax law? It's complicated? Those complicated laws have to be enforced, and enforcement costs money? Was that the headwind, do you think?

JOHN: I think that was probably part of it. You've got to get everybody on board. You have a very divided Congress, of course, relatively equal. You've got one side of the aisle that wants tax reform and the other side that's opposing it. You have the tax cut and Jobs Act tax cuts that were implemented four or five years ago.

There are certain constituencies that want to maintain that, don't want to reverse those benefits for those high-income earners. I think you're absolutely correct, Patti. That was certainly part of it.

Part of it was just simply a loss of momentum and an appetite given all the other issues that were on the table, this ballooning Federal Reserve balance sheet, $9 trillion. How do we unwind that? There were other issues that gained more attention. The tax reform really became subordinated in that political process.

PATTI: Let's talk about what they announced this weekend. How about that? Was that unbelievable? Sure enough, we think we can breathe a little bit, and then an announcement comes this weekend with a tax.

Most of the people who are listening to this are not going to be affected by this proposed regulation, but what scares me, John, is the potential down the road if they pass it and are effective in that enforcement. Why don't you tell our listeners what it was all about?

JOHN: Before we get into it – and I'm happy to do so, Patti – let me preface my remarks by suggesting to you. I think there's a very low probability that this sees the light of day. It's likely to die on the vine, just like the loss of step-up in basis that was earlier proposed, just like the increase in capital gains from 20 percent to ordinary rates for families over a million dollars.

Those were relatively controversial. Those were big ticket items, and they all wound up dying on the vine. This is likely to see the same kind of outcome or fate. It's the idea that families at a hundred million dollars would wind up paying taxes on unrealized capital gains.

Now your listeners know, of course, that we pay capital gain taxes on assets that have been sold. Gains that have been realized in the tax reporting system. This is the idea of maybe preventing or taxing dynastic wealth. Wealth that is created by me that is maybe going to pass on to my children that might escape the income tax system.

This is an idea to try to capture some revenue from it. The number was something like $350 billion that it would raise, which is a relatively small drop in the bucket but the enforcement of it, the concept of it, it's confiscatory.

I don't mean to be too negative on this because I do think we need tax reform to make the system fair, to provide benefits for those who are, maybe, less fortunate. I'm 100 percent on board with that, I'm just not sure this is the right way to get there.

PATTI: It would be really hard to prove it, I would think. How do you prove that the value of someone's business that might have been worth $50 million one year is now $150 million? How is the IRS going to know about that and therefore prove it?

That's where I get lost, the enforcement of it. Even business valuation itself is difficult. I could say that my business is worth $50 million, and if you were looking to buy a business like mine, you would be laughing your head off. You've got to be kidding me. How do you value stuff like that? It's just…

JOHN: It's counting cash flows. What is the interest rate I'm going to use to determine the net present value of that business today? Do I use comparable sales? Do I look at asset value? It's a whole can of worms. The other problem that I think you and I would have with it too Patti is, once again, I think we're OK with this idea of producing additional revenue…look COVID was expensive.

All the support that was provided. All the fiscal and monetary steps that were taken along the way. I get it. We're going to have to pay the bill for that period that we endured. We've got to find a way to raise revenue, but let's do so in a way that's logical and easily enforceable, as opposed to some of these other ideas that I think are rather problematic.

PATTI: OK. I'm going to throw three ideas at you.

JOHN: Uh-oh.

PATTI: I want you to tell me which of these three, do you think is most likely, which would be least likely. I'm curious what you might think.

JOHN: This is just a layman's interpretation.

PATTI: Layman's.

JOHN: I'm not representing any sort of tax advocacy group.

PATTI: Oh, I know. Boy, I'll tell you what you are. You're one of a kind.

Here's one. Let's raise the rates, that produces a ton of revenue.

JOHN: Ordinary rates.

PATTI: Simple. Easy. Go from 37 to 39. You just increase the brackets.

JOHN: All right. Ordinary rates is one. Yeah. What's two?

PATTI: Option two, door number two, John is raising the capital gains rate.

JOHN: Thank you, Monty Hall. Capital gain rates.

PATTI: Oh, boy. I'd rather be Vanna White. Come on.

JOHN: OK. Yes, I was dating myself with that reference.

PATTI: There you go. Monty Hall, wow. Even I remember...

JOHN: Do you remember that show?

PATTI: I sure do. I sure do. That's option two, door number two. Door number three is taking away the step up and cost basis at death, which is another very big deal.

JOHN: I'll give you my off the cuff remarks as to which of these are likely or unlikely, feasible or not. I think the loss of step up in basis would be rather controversial politically.

Stop and think about this. You own a closely held business, or you own a farm. You don't get the step up in basis at death. That means that the heirs maybe have to liquidate an asset to pay the capital gain on it. That was part of a proposal earlier on that Biden Administration had floated. It met a relatively quick demise.

I would give that maybe the least likely or the most challenging opportunity for passage.

I think raising the ordinary rates...Let's examine this concept of raising rates. What were the rates before TCGI at the max?

PATTI: 39.6.

JOHN: We're at 37 today, right? Bringing them back to 39.6 isn't really raising them. It's restoring them.

PATTI: Oh, that's a good way to put it if you're a politician.

JOHN: Maybe I should be.

PATTI: There you go.

JOHN: We raised the rates back to 39.6. I think that could be acceptable to many.

PATTI: Let me stop you there. Isn't that what the sunset provisions going to be doing?

JOHN: It is, automatically, at the end of 2025. A lot of the things that we're benefiting from today, that lower ordinary income rate, the capital gains rate. You got the NII. You got the estate tax exemption. A lot of this will automatically be undone or revert back to prior policy at the end of 2025 or the beginning of 2026. What is that, about three years from now?

PATTI: Right. That should be interesting.

JOHN: I think the current administration, though, want to accelerate the process. Given once again that unforeseen expenditure and this big deficit that we're running now because of all the outlays due to COVID relief.

PATTI: When I think about changes in tax law, and if I'm a politician, I'm thinking three things – votes, revenue and votes.

JOHN: OK.

PATTI: That's why you pass tax law changes. Here we are coming up to the midterms. What do you think about the possibility for tax law changes given those votes-revenue-votes?

JOHN: When it comes to votes and politicians, I get it. Politicians are going to have a difficult time, winning any election when they talk about increasing my tax bill. What they often counsel is the idea of increasing your tax bill. [laughs]

PATTI: Oh, that's interesting.

JOHN: Let's go after the wealthy. I think 90 percent of the American population is in favor of that. Let's go after those with the significant wealth or the significant incomes. They're not paying their fair share. Let's find the additional revenue there.

We all realize that the system itself needs reform, that the government needs the revenue. The question is, where do you get it, and how do you get it? The idea is to, once again, go after the wealthy. I'm OK with raising tax rates as long as it affects him, not me.

PATTI: It's so interesting that you bring that up in terms of what the politicians and how they're communicating it. During COVID, in one of my quarterly letters, I wrote about everything that the Federal Government was doing, from the fiscal stimulus as well as what the Federal Reserve was doing.

I gave everybody that warning to say this isn't going to be free. We should expect that our taxes are probably going to go up. In the letter, I said this, and I do mean this. The way that that money worked its way through our population, was it perfect? No, there's never going to be anything perfect. Boy, it was sure effective, wasn't it?

JOHN: We had to react to the situation at the time. Nobody saw it coming. Nobody planned for it. Nobody wanted it, but the reality is, wait a minute. The government was forcing small business owners to shut their doors, causing them significant financial hardship. We needed to step in and provide relief support. I think you and I is individuals. We're all for that.

I think we did what we needed to do, given the circumstances at the time. Now, we've got to figure out how we wind up paying for it? How we wind up resolving this big bill that we wound up footing back then?

PATTI: Again, we rely on our politicians, which unfortunately sometimes it works and sometimes it doesn't. I think about what government does with their tax revenues? What is the purpose of the government?

Then, I think about the poor people in Ukraine. You think about their government and what they're not able to do. To think that they're looking at the United States for that help. It makes me feel OK to pay these taxes.

JOHN: I love that perspective. Stop and think about the hardships that they're all enduring. The idea that you and I would pay a few more dollars in taxes to try to resolve this humanitarian crisis is an interesting thought.

In fact, I think you saw recent studies here about those. It was over 60 percent of Americans said, I'm willing to endure higher gasoline taxes by providing sanctions on Russia if it meant that I'm going to providing some support to those people in Ukraine. We're willing to pay a cost for what we believe in fundamentally.

I'd like to think that as Americans. We're OK in here. We're good people. We want good things for other people. It's not just about our own success and our own wealth. There is an empathetic side to us.

PATTI: Absolutely. At the same point, you and I being the benevolent people that we are. We also have to be practical. I feel like my role in a client's life is to make sure that they're not paying more than their fair share.

At the end of the day, as we talked about in the prior podcast, it's about helping them achieve the outcomes that are important to them. Taxes are definitely a headwind for many people.

JOHN: No doubt.

PATTI: To me, it's about understanding what the rules are, black and white, maybe a little gray from time to time.

JOHN: Sometimes.

PATTI: The gray stuff is that we don't know how the IRS would rule on it. We understand what the rules are, and then we apply the techniques that can reduce our client's tax liabilities as much as possible.

JOHN: Were it makes sense to do so.

PATTI: Exactly. Let's talk about that for a moment. You teach these courses at Yale and University of Chicago and just wealth managers all throughout the country. What are you telling all of us in 2022? What are your best ideas?

JOHN: You got a couple of hours?

PATTI: Yeah. Oh, if it's a couple hours I'm all yours, John. Totally.

JOHN: We'll do a couple hours another time, but let's go over a couple of them that may be relevant for the majority of the folks dialing in today. Number one, asset location. I mention that because I noticed that many individual investors miss this one, they pay a lot of attention to asset allocation.

How should my dollars be apportioned across different asset classes to provide the risk and return I seek, but what about asset location? Certain investments produce capital gains. Others produce ordinary income, some produce income streams that are tax-free.

What goes in what bucket? A great advisory firm like yours works with clients to not only allocate assets correctly but to think about asset location, to minimize the taxes, to provide the most tax-aware tax-sensitive outcomes for the investing that we're doing.

Here's the second idea, and this one's huge. I just finished writing a paper on this over the weekend, charitable giving. It's not to convince clients to give away more money, $470 billion were given away last year according to giving USA foundation, our clients are giving money to charity, but in many instances, they're not giving correctly.

They're going to some black-tie affair and at the end of the night, after their second cocktail, they're writing a check. While I appreciate their generosity, writing a check, it may not be the most effective way for them to facilitate their giving.

I'm a big believer in intentional philanthropy, not reactive to actually have a plan. What do I want to give to? How much do I want to give? In what forms will I want to give? With the great help of an advisory team like yours to think about which assets I give and when I make those gifts.

Think about this without getting too wonky, the standard deduction is $25,900 MFJ. All right, on the itemized size schedule A, I get 10 grand for SALT taxes. The next $15,000 of charitable giving where I write a check to charity. I appreciate the generosity. I love it. I'm all in favor of it, but it's not providing a tax benefit.

What we advocate for many people is the idea of bunching their giving, using a donor-advised fund. If I'm going to write 10,000 bucks a year to the Armenian Church, maybe I put $200,000 into a donor-advised fund today to fund this giving over the next 20 years. It's not cash it's appreciated property.

PATTI: Oh, beautiful.

JOHN: I avoid the capital gain on it. It's that kind of thinking, not giving away more money, but being more tax-aware in the giving we're doing that can help the investor achieve a better outcome and provide even greater benefit to the charities that we want to support.

PATTI: It's true. Some of the charitable trust that we looked at last year, especially when interest rates were so low, wow. Talk about home runs. Oh, my goodness. The charitable lead trusts were beautiful. Talk about win, win, win.

Everybody won with that kind of planning and it was very effective. It helped the charity. It helped from a tax perspective. Eventually depending on the term that we chose, etc. The family ended up getting the residual value that was left in the trust.

JOHN: I love it.

PATTI: It's a great wealth transfer tool on top of it.

JOHN: Yeah. It can provide not only the benefit of giving today or reducing my tax bill today but there's a third benefit that you accurately identified. It can also help to facilitate efficient wealth transfer, as well as we think a little bit later on in the process. Hey, you want to talk about that a little bit? Wealth transfer?

PATTI: Yeah, love it. Let's do it.

JOHN: We've been talking about income taxes.

There's a big tax that some of our clients may wind up seeing down the road, it's the estate tax. Not income, not capital gain it's estate taxes.

Now, I know that a lot of people are saying, "Oh, I have nothing to worry about John and Patti $12 million exemption." When I started in 1981, the number was 600,000. It's 12 million today. That's 24 per couple.

I have three questions to ask that client. Number one is when do you plan on dying? Number two how much will you have at the time of your death? And number three, what will the number be in the year of your demise? Of course, we can't predict any of those things.

It really suggests that people should have a conversation with their advisors about where do you want your money to go? What's important to you? What steps can we take to facilitate the efficient transfer of these assets, to the entities or the people that you want to receive them?

PATTI: It's so true. There are so many different ways to do that. Some more painful than others. There's a lot of things to think about. To your point, it's not necessarily whether or not you have a taxable estate today. That's probably not relevant.

The question's going to be, what's it going to be in 20 years from now? Or even longer when the second person, if you're married, passes away. What can you do today to reduce that exposure?

There are lots of things that people can do that don't have to be necessarily painful. Do you want to talk about a couple of those? We could talk about slats. We could talk about annual gifting.

JOHN: Yeah. Well, let's talk about some of the basics first because sometimes some of the best solutions, or at least where we should start is with the more fundamental opportunities.

Like when we talked about charitable giving, I can look at CRTs. I can look at CLTs.

I can look at private foundations, but maybe for many people, "Hey, let's start first with a donor-advised fund to derive the benefits of bunching my deductions and tax-free growth inside the account and the opportunity to give appreciated property and avoid the capital gain. Let's start there. If a more sophisticated or complex solution is required, we can move on from there."

Let's do the same with estate planning. The obvious one that everybody misses annual gifting. I think the number one from 15,000 to 16,000, and so John and his wife Lucina can give $32,000 and can give it to Margo and to Daniel and can give it to their spouses if, and when they get married, keep your fingers crossed for me. Then grandkids, keep your fingers crossed for me.

This is a very effective way for families to not only reduce their estate tax bill, both the current value plus the appreciation on it but also to see the benefit and the joy associated with giving while they're alive. I think that's a pretty cool way to start the process.

PATTI: There's another unintended benefit that a lot of families get from it, and that is how are the kids going to deal with that?

JOHN: Well, I like this idea.

PATTI: Because it's very interesting when you start that gifting, are they going out and putting it towards a nice car? Or are they funding their child's 529 plan? That says volumes because that then helps me as the advisor to say, "You know what, maybe you wanna consider doing a trust in your will so that the kids get a little bit at a time."

Maybe, 5 percent when they're 30 and another 10 percent, when they're 35, that way they can't blow it all at once. They become used to this idea of having the assets, having the money, and what to do with it.

JOHN: Love it.

PATTI: If they get it all at once, it's the sudden money issue. People who win the lottery, right? I had a client early in my career who won the lottery. I got to tell you, I was shocked at how quickly they went through that money. It was a lot of money.

JOHN: We see it with professional athletes, we see it with lottery winners. We see it with people who wind up with a sudden windfall. Susan Bradley, that Sudden Money Institute.

PATTI: Yes, absolutely.

JOHN: She does some really good work on that subject.

PATTI: Phenomenal work. I've learned a lot from Susan in terms of how to guide people. I didn't have Susan Bradley when I had that client as a lottery winner. It is fascinating and really important.

The annual gifting idea that you've brought up, it's just a nice way to put your toe in the water and get a feel for how are the kids handling it.

JOHN: I love it. This idea of financial literacy for that next generation is so important to so many people. If you asked me, if we were having a beer at the end of the day, "John, what keeps you awake at night?" OK, I talk about retirement and how I'm going to have purpose in my life when I stop doing what I do. That's something that's on my mind.

Running out of money, knock on wood, hopefully, OK on that front. What keeps you awake at night are my two kids and they're good kids by the way. Have I done what is required? Have I done what's available to me to teach them about financial responsibility?

You see it all the time Patti, wealthy families, God bless their success but sometimes money does bad things to good people and it causes bad behaviors, entitlement and lack of motivation and materialism and big egos. How do we as financial advocates for our clients, how do we help them instill the right values and the right financial literacy in their children? I think we can do some good work on that front.

PATTI: I think we can as well. I love the idea of these incentive trusts, giving the kids a sense of the values. A lot of people, we actually meet with the attorneys with our clients because I think it's important for clients to realize that a will or a trust It's just a letter.

It's a letter from you to the executor or the trustee describing what you'd like to have happen with this money that you've worked your entire life to accumulate. You can share your values, you can talk about that and if you don't want to put it actually in the document, you could write a letter and attach it.

I just think sometimes a handwritten letter in blue pen from Mom and Dad, is it like haunting the kids from the grave? Maybe a little bit but if its values oriented, and is there to teach the kids about the money and the responsibility that has been bestowed on them with the money, it can provide a terrific benefit.

JOHN: I love that idea. We've developed a curriculum on how to help families instill the proper values in their children and the financial responsibilities. A really good book I just finished reading, actually two of them, one of them is called, "The Opposite of Spoiled," written by Ron Lieber.

He's a columnist for "The New York Times."

PATTI: He's so good.

JOHN: He's good, and it's a cool title, isn't it? The Opposite of Spoiled.

PATTI: I got to get this book.

JOHN: It's good. I'll send it to you. I got a couple of copies back in my Chicago home office. The second one is called, "Kids, Wealth, and Consequences," written by Richard Morris, and he suggests that we teach our children a number of really important lessons.

Now the children he's referring to are probably elementary school children, but I think the concepts apply across the age spectrum. Number one is that we have to teach them how to hear, "no," because too often as parents of a successful family we just give them what they want.

I'm not sure we're helping them in that process. The second thing we have to teach them is the difference between wants and needs. What is it that you want in life? What is it that you need in life? Third, delayed gratification. My son asked me for an 85-inch Samsung 4K OLED TV when he was going to college. What was the answer? No.

You're not getting the TV, and I said, "Look if you come on home, and work during the summer, Mom and I will match dollar for dollar everything that you're able to save and put aside for it." It took him a little bit longer to get there, but he got the TV, and I like to think he learned from the experience, and he probably appreciated it a lot more than he would have if I had simply given it to him.

PATTI: It's interesting. I didn't plan on telling you this story, John, but I would like to share something with you. When my kids were little...of course we were really crazy, and life was work and it was family, and our idea of going out was going to Kmart.

When we take the kids to Kmart we had two rules. Number one, "stick like glue," because my kids were always roaming, especially...

JOHN: You don't want to lose a kid in a Kmart.

PATTI: It is happened, it is happened. The Blue Light Special was, "Patti, Carrie's up at the front again," right?

JOHN: Exactly.

PATTI: That was number one. Number two was no begging. No begging. Every once in a while, they were kids right, so they would test the boundaries, and they might ask for something.

My response was not, "We can't afford it." Because I heard that growing up. That made me feel financially insecure.

JOHN: That's not good.

PATTI: What my response was, we don't choose to spend our money this way. Six months from now, you're not going to know what that toy is, where it is, etc. I think you're going to thank me when you graduate from college.

JOHN: I love it.

PATTI: It was beginning that delayed gratification that you referred to.

JOHN: These are great lessons you're teaching the kids. Here's a similar methodology that I've seen work for other families. Family vacation, not the Kmart shopping trip, but similar idea.

In our family, my wife does all the heavy lifting on the family vacation. From Wilmette, you're going somewhere on for spring break. Of course, everybody does. My wife used to do all the heavy lifting, was a lot of work.

Finally, when the kids became teenagers, we said changing rules. You guys on the family vacation this year.

PATTI: Wow.

JOHN: We gave them a number. They then did the research. Are we going to Bermuda? Are we going to Hawaii? Are we going to Florida? Where are we going on vacation?

You're going to decide where we're going to stay. You're going to decide if we're going to fly coach or first class, or are we going to stay in a holiday inn or a four seasons? You're going to decide where we're going to eat at night. You are going to make the decisions on budgeting.

Our kids learned a couple of important lessons. Number one is how much work it is to go on vacation instead of just showing up with your backpack. You're going to have to do all the work to pull this off. Hopefully, you're more appreciative of the opportunity.

Number two is you're going to learn the lesson of how expensive a vacation is. A lot of kids don't know how costly it is to take a family of four on vacation. Thirdly you're going to learn how to budget. Where you're going to allocate or apportion your decisions in terms of what you want to use or what you want to spend while you're on vacation.

PATTI: I love the way you frame that. Allocating capital instead of using the word budget.

Everybody who knows me knows I'm not a big-budget person.

JOHN: I hate budgeting.

PATTI: It sounds like we have to give up something we really like, like a diet. I got to give up something that I love to eat.

JOHN: It's not a pleasant experience.

PATTI:	No, no. I don't want to do that. Allocating capital is very positive.
JOHN:	There you go.
PATTI:	Allocating income is very positive. Now, let's bring a circle back and say it's taxes. That's one form of capital that I don't want to pay as much. Charitable giving is huge. Estate planning is huge. I personally think and worry that people are becoming a little too complacent as it relates to their estate planning. One way or the other, we're probably going to get the sunset provision. That amount that you can leave to the next generation is going to go down when hopefully, net worth people's...
JOHN:	Is going to go up.
PATTI:	...is going to go up.
JOHN:	What do you think that number, excuse me, is going to be? I know it's 12 million today. We had to saw a modest increase due to inflation adjustments for 2022. Any ideas on what people should be thinking about?
PATTI:	I think the low-hanging fruit is to go back and let everything sunset to prior to what it was in 2017. We're talking around six million.
JOHN:	For per couple?
PATTI:	No, per person.
JOHN:	Oh, per person.
PATTI:	That's what I'm thinking. What are you thinking?
JOHN:	We don't know, but we do think it's going down. Maybe there's some sort of an adjustment between now and then that makes it a more modest number. Directionally, we're on the same page.
PATTI:	Interesting.
JOHN:	It's going to be a significant...Let me put it this way. It's not going to be more than 12 million dollars.
PATTI:	No way. No way.
JOHN:	I'm willing to bet you anything you want that that number is going to be significantly

lower. Families that haven't thought about it, families that have chosen, who the heck wants to talk about estate planning?

PATTI: I know.

JOHN: What you're bringing up two of my least favorite subjects – A my death and B the taxes I pay? That doesn't sound like a very pleasant conversation. I'm hoping or assuming that you found a better way, a more enjoyable or productive way to bring this up with your clients.

PATTI: The way that I try to frame it, John, is to really think about it in terms of the amount that you can leave to the people that you love.

JOHN: I like that.

PATTI: When we leave money, when we pay our taxes, we've talked about that that's an important role that we all play. The Federal Government may not allocate that capital the way that you would want to allocate it.

JOHN: That's good.

PATTI: By doing this estate planning, if there are charities that you feel strongly about. I don't know about you, but I always tell people that the tax law is out there to create an incentive for all of us.

JOHN: For behaviors.

PATTI: Exactly. It's not to punish us. It's to encourage us to do things like save for our own retirement instead of becoming dependent on the Federal Government and Social Security. To save for our own medical care in the form of HSAs.

JOHN: To be long term investors, because we're going to give you a lower capital gains rate. It's to incentivize good behaviors that are in your best interest.

PATTI: Exactly. With that in mind, that's fine and dandy. Why don't you take that incentive, and think about how you'd like to allocate that capital. Your kids, or the people that you love, get the rest. They get to do the same thing.

It's all again, just like you were talking before, it's communicating the values to communicating what's important to you about your money. At the end of the day, it's a stewardship. Most of our clients, and those of you who are watching today. No matter how old you are, and no matter how much money you have, you really worked hard for that.

What you have is money that you have after you pay the taxes. It's a stewardship over your hopefully very long life, or maybe it's a little bit shorter. It's a stewardship to determine what can happen over the rest of your life, and what do you want to have happened afterwards.

We talked about compounding being the eighth wonder of the world. I think it's really cool. You'll appreciate this. We're talking about estate planning and taxes and all of that. I went to a meeting one time it was at a Forbes' or a Baron's, one of the conferences. I'll never forget this, John.

While I was sitting in the audience with about 500 CFPs. The person that was up on the stage was talking about this estate planning. They asked the question. They said, "I'd like to see your hands. Raise your hands if you can remember the first names of your grandparents, at least just one of them." Most of us raised our hands. Great.

"Now I'd like you to raise your hands if you can remember the names of your great-grandparents" Do you know that nobody raised their hands? Then he said something that has stayed with me ever since. He said, "Isn't it a shame to think that 100 years from now, people aren't even going to remember our names...

JOHN: Interesting.

PATTI: "...in our own family" We talk about this thing called legacy. We talk about estate planning and taxes and all of that. It's more than that. It's about legacy. While we're alive, we get to do things that can create impact on other people's lives. You do it by being here today. You've created so much impact from me, John, in the short time that I've known you.

I'm going to be enrolling in a graduate degree program, because I learned about it because of you.

JOHN: Love it.

PATTI: Hopefully that will make me a better advisor to the people that I serve. That's what we do. We get to have impact in the lives of people around us. Taxes, yes, they are important. We want you to keep more of your own money so that you get to do with it what you want.

JOHN: I love it. What you're referring to in these great examples is control, right? In a positive way. Control that I decide where my hard work and efforts, where that goes. Does it go to my family? Does it go to a government program? Does it go to charities I want to support? I think that's what all of us want.

As successful people, we want some control or influence over what happens in our lives and what happens in the lives of others. That's empowering. That's good.

PATTI: What we've learned today from you between this podcast in the podcast before, and by the way, as John said we could be here for hours and hours talking about the tax planning techniques. Some may apply to your situation. Others do not. Take what applies to you and throw out the rest. There's a lot out there.

What we learned with the prior podcast in terms of this concept of control, right? We can't control markets. We can't control a lot of things. What we can control is what we do about it. That's what it's all about. To understand the impact in your lives on a personal level.

John, I can't say enough about you and what you've done. I appreciate your time today. I appreciate you Dan Miller at PIMCO for bringing somebody of this caliber to my office. It's just incredible. I'm so grateful to you for tuning in today and listening to us and watching us. I hope it's been helpful. John's favorite four-letter word H-E-L-P. That sings to my heart. That's what it's all about.

Can we make a difference in your life? I hope we've done that for you today. Thank you so much for tuning in. I hope you have a great day.

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