KEY FINANCIAL, INC.

Ep. 186: Decoding the One Big Beautiful Bill Act with Eric Fuhrman

Patti 00:12

Hi, everyone. Welcome to the Patti Brennan show. Whether you have $20, 20 million, or 200 million, this show is for those of you who want to protect, grow, and use your assets to live your very best lives.

Patti 00:29

Joining me today is Eric Furman, our Chief Planning Officer. We're going to be talking today and answering the questions that we have been getting over the last few weeks on the new tax law, the "One Big, Beautiful Bill Act." What has changed? What is the same? How are we going to be affected? And I want you all to know that Eric actually did a deep dive.

Eric 01:19

So for anybody out there, all of this stuff exists in the public domain. So for example, if you go to congress.gov, you can look up the One Big, Beautiful Bill, or any other bill that might be introduced or working its way through the legislative process. But you know, to me, it's just very interesting. It's a way to really get into the details of what is in all of this legislation that has broad implications, not just for individuals and what we might recommend to our clients, but also broadly across producers and businesses all throughout the economy.

Patti 02:01

It's interesting. You were talking about the different sections and how the legislative process works, and how each section is really siloed when we think about how this whole thing called the US government is run. Now we're going to be focusing on Section Seven today, right?

Eric 02:19

Yeah, so if you look at the One Big Beautiful Bill, it's actually arranged by titles. And I believe there's 10 titles that they have, but essentially each title is a committee that exists in Congress. So if you get elected to Congress—eventually you'll eventually serve on one of these committees. And these committees are tasked with doing work and designing laws and so forth that ultimately ends up in these bills. So you know, for example, if you look at Title One, that is the Committee on Agriculture, Nutrition, Forestry. Title Two is the Armed Services Committee.

Patti 02:57

So basically, if I hear you right, they are making decisions on how to allocate the resources that have been allocated to them, and they're asking for more. They're saying, "Hey, we're good," et cetera, and how they're going to be using those resources?

Eric 03:12

Yeah, so precisely. Based on the work that is done by each one of these committees, and I assume they have access, obviously, to lots of data and information, expert witnesses and other people that come in and provide guidance, but ultimately, you're right. They're drafting laws that are meant to kind of divvy up the pie. How do you apportion funds for certain objectives or entities in the government, and also write rules and regulations that incentivize certain behaviors, punish others, you know, things like that.

Patti 03:44

Well, you know, we were talking about this before coming live, and we were talking about the tax law in particular, and how the tax law actually creates incentives for Americans to do certain things. For example, there's a tax deduction for charitable contributions, so that, you know, the US government is not the only entity that's providing social services. So if we contribute to a named charity that we believe in, we get a tax deduction for that. That's an incentive. I was given an incentive when I started Key Financial and Eric, you and I worked together in my basement, which, frankly... those days... and I'm going to show you pictures. This is us in the basement. It was unbelievable. At one point, we had nine people coming in, in your shorts, raiding my refrigerator on the way down to the basement.

Eric 04:37

Yeah, yeah. I remember the food bill must have been outrageous.

Patti 04:41

It was, and I did not take any deductions for the food that you ate, Eric, but I did deduct a portion of the home that represented the square footage, and that allowed my taxes to be lower, gave us more cash flow so that I could hire more people. Here we are at 33 W-2 employees and we've grown significantly because of the incentives that I was given as the owner of Key Financial and continue to receive. So that's the takeaway now. Taxes are really there to provide a social net, right? And I thought it was also interesting. What was that guy's name in the '20s?

Eric 05:23

So Andrew Mellon, Secretary of the Treasury.

Patti 05:27

Secretary of the Treasury. And he had a quote. What was his quote about... something to the effect of... what was his quote? I wrote it down somewhere.

Eric 05:38

You mean about debt? Yeah, like federal debt?

Patti 05:42

Yeah, yeah.

Eric 05:46

Essentially, you can't have a financial crisis if you owe money to yourself, like a nation is not in danger if it is... or something to that effect.

Patti 05:55

Okay. Basically, he said something to the effect of a nation is not in danger of disaster or a financial crisis if it owes the money to itself. And essentially the government debt is owned by Americans, so we owe it to ourselves. And I think it's also interesting to point out that with tax policy and the taxes... we talk about government spending, and you can talk a little bit about the charts that you pulled up, but you know, it's not all spending. It's also investment. When they allocate these resources, they are investing in infrastructure. For example, roads, bridges, railroads. You guys get to come to work because there are roads to get here. So that's important to differentiate between, you know, ridiculous spending and actual investment that increases our GDP.

Eric 07:01

And I think that's an important point, and maybe it is a failure of the nomenclature in which they talk about spending. But you know, it just tends to be viewed if the government spends money, it's an expense. But within there, there are a lot of investments, for example, that are made. So not all spending is bad spending, if it is an investment in something that will provide a future return or benefit to society. So think about the national highway system that was invested in when I think Eisenhower was in office. Those types of investments derive a return that society gets. So all spending isn't bad spending, but certainly there is, you know, the potential and the likelihood of a lot of spending that might be wasteful that obviously is problematic. That's obviously not good spending if you're accumulating debt, and it's not into things that can provide some kind of future return or future benefit and so forth. But they don't cleanly separate those things out in the data.

Patti 08:06

And they can even reframe things and use rhetoric to say, "This is going to be really good for Americans," type of thing. Folks, those of you are watching and listening, I promise you, we're going to get into the tax law and talk about how you may or may not be affected by it. I just want to talk with you, Eric, about one additional thing as it relates to tax and legislation and tax rates over time, and how they've tinkered with the laws a lot since 1950. But when you really look at the numbers, the revenue that is produced is within 2% or so of GDP. It has always been between 15% and 17% of GDP, the total revenue that's generated, even though tax rates in the '50s was 80—the top rate was 80 to 90%. Our top rate has been 30 to 40% in the last decade, and yet the amount of revenue is still about 17% of GDP.

Eric 09:15

Yeah. So I think that's an interesting observation. We've had, if you just go back to, I think, 1950—so we're in the post World War Two era—there have been many, many major pieces of tax legislation that changed tax laws, changed deductions. I mean, if you go back into the '70s, we had far more tax brackets than exist today. But there's been nothing but constant change in the rules. But to your point, if you think about the size of government, and you could measure that basically as the amount of tax revenue as a percentage of GDP—that would be, I guess, one way to measure the size of government—despite all those changes, all these major pieces of legislation, you're right, the tax revenue is always about 15 to 17.5% of output. Regardless of all this change, government always seems to represent kind of a constant percentage, and sometimes it deviates outside of those ranges, but it's always very consistent despite these very bold and dramatic bills. Ultimately, what is it really changing? In the grand scheme of things, it doesn't really change the footprint of government all that much.

Patti 10:35

Although, for people who look at the raw numbers—look at the size of government, right? Look at the amount of debt we have. But let's be honest. I mean, our GDP has risen since 1950 from $2.2 trillion to almost $24 trillion—that's 10 times in terms of growth. So it feels like our government has gotten so big because it has, because the size of our government has increased tenfold, just using that constant of 15 to 17% of GDP.

Eric 11:17

Right along with the economy. But people are far better off today—again, on average—people are far better off today as a country of life than certainly they were in the 1950s. And even when you go back to Andrew Mellon—he was Treasury Secretary, I guess, back in the '20s and early '30s. But you can read speeches by him. And even then, in the '20s, he talks about how America, at that point in time—and that's well before the 1950s—was one of the most prosperous nations on earth, how people are doing and how citizens are living. So this has been a very kind of durable trend that has persisted if you go back and look into things through the lens of history.

Patti 12:05

What you said before we went live is that if you read that speech, that speech could be given today.

Eric 12:13

Oh, yeah, it's amazing. If you go back and read some of the speeches from then, there's so many elements that just are applicable today. You'd almost think some politician today was giving it. But you know, I think let's... why don't we turn our attention to the bill? And again, unfortunately, it's a big bill as the name says, so we're not going to be able to go through them. So I think what's kind of germane to our conversation today is the discussion around Title Seven, which is the Finance Committee's work here, and this is where they really get into things that affect our clients and listeners out there, in terms of individual tax rates, deductions for anyone out there who's an entrepreneur and a business owner, affecting, obviously, the opportunities to depreciate, deduct and other things like that. So what I found interesting, kind of diving into that on congress.gov is that there are elements of this that are permanent, right? And I think for those of us that operate in this financial ecosystem, if you're an advisor or a CPA, maybe estate planning attorney, there's an element of this that is good because it's created some certainty, right, in terms of advising people and giving them the advice, where you know that advice is going to be sound as we move forward into the future. But the other interesting part is, there's a lot of elements that are in there, but they're temporary. These are not permanent things, and these more seem to fall along the lines of the campaign promises to deliver on them. But they're not necessarily permanent elements. So they'll be here for a period of time, but they may not be here in the future, because they're not extended, or they expire.

Patti 13:57

And this is where I think it's really important that we caution people to really understand the landmines that are out there, especially with these temporary changes. Some apply in 2025, some don't start until 2026, some go until 2028, there's a couple that go to 2030. So there's a number of things to pay attention to. Always seek advice from your tax advisor, your CPA. We are never going to be able to replace those relationships. They are the experts. We're just here to give you the high level stuff to pay attention to.

Eric 14:38

Yeah. So I guess my thought is maybe for listeners out there, maybe we can start by highlighting some of the things that are permanent, where at least we have some clarity there and certainly affects the kind of the everyday person.

Patti 14:53

Perfect, so I can list them for you. Okay, great. Folks, get a pencil. Write these down. Tax rates stayed the same, the estate tax rates starting in 2026 have become permanent. So each individual has a permanent exemption of $15 million and what that means is a couple has $30 million that they can leave to the next generation or anyone, and there will be no federal estate tax. The excess over that amount would be taxed at 40%. The standard deductions have become permanent. And there is a perk, a temporary perk, for those people listening that you're advising who are 65 years and older, there is a new additional standard deduction of $6,000 per person.

Eric 15:52

And this is the one that I think was marketed as for seniors, so they wouldn't pay any taxes on Social Security. So I guess that's the way it's presented, but it doesn't actually operate that way when you kind of work your way through the 1040—meaning the individual tax return.

Patti 16:11

Yeah, so be careful with that one. It's terrific, and many people are going to benefit from it, but it doesn't necessarily mean that your Social Security is not going to be taxable. The miscellaneous itemized deductions—permanently gone. However, for those of you who are teachers and educators, there is a new non-miscellaneous deduction for expenses that you pay for your kids—for educating the people that you are teaching. And that is brand new, and that is also permanent.

Eric 16:51

So what about—I feel like one of the big ones that's hanging out there is this whole modification of the SALT cap. Because I feel like this is something that catches so many of our clients and many people—you don't necessarily have to be a high income earner—where they limited the deduction for state and local taxes to $10,000 and it was capped. So that really impacted people that have high property taxes, or people that were high income, or just happen to live in states where there's a very high state income tax rate, like New York or California, for example. Those states are really pushing for this increase. We're in Pennsylvania, it's 3% so it's not zero, but that modification, I guess, is going to be big for people, where, for the last eight or nine years, most people are just taking the standard deduction. But now the ability to go back to this itemization door might be open. So how's that?

Patti 17:47

Very interesting to see the impact on our clients, because they increased that amount from $10,000 to $40,000. Of course, there are income limitations. So if you have an income that is below $500,000, you get the $40,000 SALT deduction. You can go up to $40,000. Between $500,000 and $600,000, it begins to phase out. If the modified adjusted gross income is over $600,000, you're back to square one with a $10,000 cap. So again, there's always caveats and stuff like that, but it could be really beneficial for many people.

Eric 18:32

Yeah, and I guess the key thing there, too, is with the change in the SALT deduction, that then means that people may be able to start deducting mortgage interest.

Patti 18:44

Oh, 100%. So like to your earlier point about what is government policy doing? It's incentivizing certain behavior, right? Here, deducting mortgage interest is incentivizing home ownership, but a lot of people couldn't take advantage of it exactly, because they were just taking the standard deduction anyway, so they weren't deducting it. There is a new twist on that, Eric, and that is for people who are paying mortgage insurance premiums. I think starting in 2026—I could be wrong on that—that's going to be bundled into the mortgage interest deduction. Again, people used to be able to write it off, and then they got rid of it in 2017. It's now back in. So again, if you're paying mortgage insurance on your mortgage premiums, you can deduct them again.

Eric 19:30

And you know what's interesting there? I mean, this is just speculative on my part here, but when you think about the incredible, prodigious increase in the cost of housing, you have to wonder if a lot more people that have purchased a home are paying mortgage insurance because they couldn't meet that 20% down payment. So maybe that will provide some extra relief to new homeowners.

Patti 19:53

Exactly, yeah. We were talking about Elon Musk and the amount that he contributed to the campaign, etc. And it was interesting that within this bill, most of the clean energy credits are gone. However, you brought up this new space bond that is out there now. So if you invest in a bond that is investing in space in some capacity, the interest you receive on it will be tax-free.

Eric 20:24

Yeah, so that's a new development, I guess, in the market for tax exempt securities. Now we might start seeing space bonds issued. And essentially, these are no different than a bond that might finance the construction of a highway or a hospital or something like this. But these would be bonds issued to finance the construction of infrastructure for space activities. And essentially, those bonds are tax exempt from federal taxes. So I have not seen one yet. But who knows? Five to ten years into the future, they might be more common.

Patti 21:03

It'll be interesting to see the maturity on these bonds. Are they going to be 30 year bonds? What is our world going to look like in 30 years, especially up there in space, right? Think about what we've done in the last 30 years.

Eric 21:17

Yeah, absolutely. But I think you're right too. The other elements here, if you look at some of these other sections of the bill, certainly tax credits that had been historically provided for clean vehicles and other energy efficient improvements—all things where the tax code had provided deductions and credits—a lot of those things are going to be scaled back or stripped out anywhere between October of this year and early next year. So if you are contemplating the purchase of some of these things where there's a credit, there might be an incentive here to do some of that.

Patti 22:00

Some of the credits are kind of juicy. I mean, the solar credits and things of that nature. So, you know, again, we're not encouraging people to spend their money frivolously, but if it's something—to your point—if they're thinking about it already. So let's continue with some of the temporary stuff. There's no tax on tips, it's basically a deduction, and overtime, right?

Eric 22:28

So I think the tax on tips, that's an interesting one, because I think it's as long as it's qualified tip income. So for anybody that's working in the service business, where you're receiving cash and not reporting it, things like that, but it's got to be qualified income that's kind of run through your W-2 and I think the limit there is $25,000, right? So up to $25,000 you can exempt.

Patti 22:51

Yep, yeah. And I think you've brought up a good point with that one, as well as all of the others, there are tax torpedoes in this new legislation. We've always had to deal with unintended consequences when we're making recommendations, and we find sometimes with Roth conversions and the 12% tax bracket—those are two areas that we really like to look at towards the end of the year to really see if clients can take advantage of them. But again, there are some landmines with those things. Somebody might find themselves in the 12% tax bracket, taking capital gains and having to pay 15% on it. That doesn't make sense, right?

Eric 23:40

Yeah, I think it's interesting too, even though some of these deductions and limits and things like that have changed, I think the basic principles still apply as if this bill hadn't been passed, which is, you just have to be very careful before making these decisions and really running the numbers or having a professional run the numbers, because ultimately, all these things are interconnected. So doing one thing can diminish the benefit of that transaction somewhere else on your tax return. So I think you always have to continue to be prudent in making any of these—considering any of these opportunities.

Patti 24:19

You know what, Eric, how about this? These new Trump accounts that are being established for children that are born, right? And we were talking about the mechanics of it, it's not going to be like a tax deduction per se or a tax credit. They're actually going to—for every child that is born next year or later—they're going to throw $1,000 into an account for that child, and you can also contribute up to $5,000 per year. And of course, that baby's not working. You don't have to have earned income to be able to have these accounts. And at age 18, that child will own the account. So it's very interesting. I'll be interested to see the actual implementation of that and how it's going to work, but that's a great planning opportunity for many families and their children. So when they're 18, they do a Roth conversion of that account, and it could be sizable, depending on how many contributions have been made.

Eric 25:18

Yeah, again, I guess that's one of these kind of interesting temporary elements that's in here, something kind of totally brand new, but it's temporary, and I guess we're still trying to get our arms around how it works. But yeah, so my understanding is the same, that within this period of time, this window, the government will contribute $1,000 for any new baby born. That doesn't incentivize... I think for me, the ship has sailed. So we're not going to be having any more kids, at least at my stage in life.

Patti 25:48

I don't know that $1,000 is enough of an incentive, knowing the cost of raising a child.

Eric 25:53

Oh, yeah, yeah, when you think about daycare, summer camps, all that good stuff. But now it's an interesting tool, and I think there's the ability to contribute, I think, $5,000 a year up until they reach the age of 18. So just kind of a new account. But again, it's not permanent, so I don't know how this will all resolve itself once these things expire and so forth. But you know, it's interesting when you talk about that, and we're thinking about kids, this is kind of a good segue into looking at other elements, like 529 plans, for example. Love this part. So they've expanded... normally, 529 plans traditionally were a vehicle to save and use for education, like in a university setting and so forth. But then they expanded that to K through 12 education. But the limit there was $10,000 a year. And apparently, within this new bill, they've expanded that to $20,000 a year. That's a nice little perk. So it doesn't have to wait until your child matriculates into school at age 18. It can be used, if you're using any kind of religious based or private education.

Patti 26:59

And they did increase the child tax credit to $2,200 from $2,000, so that was good for those families out there that are listening. That's the good news. I will say that on the other side with the itemized deductions, high income earners are going to be kind of hit again. While they permanently repealed and got rid of that old "Pease limitation" for itemized deductions, there's this new, very funky calculation—two divided by 37—and it's applied to your income, and your itemized deductions get reduced by that amount. It's really funky. So even though you might have a lot of itemized deductions, they might be whittled down a bit, not by a lot. Again, most of this stuff is just some tweaking. I don't think anybody listening is going to get hit hard by this new tax law or benefit greatly either. But there are some things to be aware of.

Eric 27:58

Yeah, so I guess leave it to the government. They've made things more complicated. It is so complicated, yeah, but I guess that's interesting too. There was some criticism here, especially on the higher brackets. Those rates are more or less made permanent, but ultimately, the devil's in the details. So a lot of these deductions and other things may be phased out for people that find themselves on the higher end there, so they may not derive the benefit of some deductions.

Patti 28:25

Okay, so that's a good segue. Let's kind of summarize this, Eric—winners and losers.

Eric 29:22

Yeah. So I think your concept of winners and losers... when you look across the bill, there are certain elements, when you look at these committees, where they are expanding funding, reducing rules and so forth, that make the cost of business going down. So, for example, if you look in the agricultural sector, expanding funding there, Armed Services, defense, expanding funding there. If it's Homeland Security or the Judiciary, they're expanding funding. So in essence, you might think that those might be the winners in those particular segments. If you think about what we're talking about today, the tax portion, I think in general, it generally benefits middle to upper income households, just in terms of tax relief and so forth.

Patti 30:16

The other thing is, the estates, that's a big perk, right? The ability to transfer assets to the next generation without taxes. And having an understanding of the rules of the game—the $15 million is permanent and increasing by inflation each year. So you're right, corporations, high income estates, people with newborns, families, there's some nice perks in there. And the SALT increase is a nice thing, and tips and overtime, again, these are temporary. People who do not benefit, or I don't want to call it losers necessarily, but low income families reliant on Medicaid and SNAP—a lot of those programs have changed. People who are investing in clean energy and those sectors and communities facing health or food aid cuts. So people are worried about deficits, and our deficits are going to rise. We've talked about that from the beginning, but that's really how it all shakes out. It's mostly tweaks. It's not going to be significant, I think. And again, we're going to be running numbers and talk to your tax advisor and see how it all shakes out on an individual basis, right?

Eric 31:36

Absolutely. And I thought an interesting little part towards the end of the bill is that they did increase the debt limit by $5 trillion. So I would expect, regardless of what you feel about the bill, the reality is, they recognize that the debt will continue to increase, and it doesn't seem to be slowing down.

Patti 31:58

No end in sight, right? Yes. So thank you, Eric for joining me today, and thanks to all of you for joining me as well. If you have any questions, as always, go onto our website at keyfinancialinc.com, we're happy to answer any questions you might have. Eric Fuhrman, our Chief Planning Officer, thank you for all the research that you did.

Eric 32:56

Thanks, Patti. Delighted to be here always. Podcast day is always a fun day. I have trouble sleeping the night before.

Patti 33:10

You and me both. We do a lot of prep work for it, but it's important, because we want to get it right. And there's so many things out there, folks, that are incorrect or leaving out important caveats, so be careful. Thank you for joining us. I'm Patti Brennan, CEO of Key Financial. I hope you have a terrific day. Take care.