Do You Consider Taxes as You Invest?

A few astute moves could help promote a better after-tax return.

As you weigh risk vs. return, you may risk taking an eye off taxes. A focus on tax efficiency could help you improve the effective yield from your portfolio.

You can try to cut or delay taxes linked to investing. Consider placing the most tax-efficient investments you have in taxable accounts, and your least tax-efficient investments in tax-advantaged ones. In your taxable accounts, consider investments that are passively, instead of actively, managed. Active Management involves more frequent buying and selling of assets, tends to generate higher transaction costs, and will have tax consequences to moving positions frequently. Think about directing investable assets into accounts that offer the potential for tax-deferred growth and tax-free withdrawals, such as Roth IRAs. At the very least, look into your tax-deferred retirement accounts such as 401(k)s or 403(b)s.[1]

Tax-loss harvesting can be a smart move any time of year. By selling securities for less than what you originally paid for them, you incur capital losses. These net losses can offset short-term capital gains, and you can deduct them against regular income for tax savings. You can deduct as much as $3,000 in capital losses each year and carry forward additional losses to the following tax year. You just have to remember two things. One, tax-loss harvesting is only allowed in taxable accounts. Two, you must abide by the "wash sale" rule: you cannot claim a loss on a security if you buy the same or substantially identical security within a 60-day window of liquidating your shares.[2,3]

This information is not intended to be a substitute for specific individualized tax advice. We suggest that you discuss your specific tax issues with a qualified tax advisor. The Roth IRA offers tax deferral on any earnings in the account. Withdrawals from the account may be tax free, as long as they are considered qualified. Limitations and restrictions may apply. Withdrawals prior to age 59½ or prior to the account being opened for 5 years, whichever is later, may result in a 10% IRS penalty tax. Qualified accounts such as 401ks are accounts funded with tax deductible contributions in which any earnings are tax deferred until withdrawn, usually after retirement age. Unless certain criteria are met, IRS penalties and income taxes may apply on any withdrawals taken prior to age 59½. RMDs (required minimum distributions) must generally be taken by the account holder within the year after turning 70½ .

[1] forbes.com/sites/fidelity/2016/03/14/how-to-invest-tax-efficiently/ [3/14/16]
[2] usatoday.com/story/money/nation-now/2016/11/08/5-ways-you-may-messing-up-your-investments/93297140/ [11/8/16]
[3] bankrate.com/finance/taxes/capital-losses-can-help-cut-your-tax-bill.aspx [12/16/15]

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