

SIX STRATEGIES TO REDUCE YOUR TAX BILL

Minimize taxes by maximizing tax-efficient investing strategies

When it comes to income, it is often said that it's not what you make but what you keep after taxes that really counts. The same adage holds true for investing too.

Taxes are an often overlooked expense that can erode portfolio return. While taxes should not be the sole focus of your investment decisions, they should be a factor to help you maximize your after-tax returns. This approach is particularly important for investors in higher tax brackets who are investing in taxable accounts.

BUILD WEALTH THROUGH TAX-EFFICIENT INVESTING

Tax-efficient investing is a key component to building wealth, yet it can be challenging for individual investors to do given the amount of research and planning required. Save time and taxes by implementing some of the strategies below.

- 1 Design a Tax-efficient Asset Allocation Plan.** Your first step toward a tax-efficient strategy is deciding what types of accounts to hold your investments in. Since different investments and accounts have different tax treatments, one of the keys to tax efficiency is holding investments in the appropriate account. In general, investments that tend to lose less of their return to income taxes are better for taxable accounts. Likewise, investments that lose more of their return to taxes may be best in tax-advantaged accounts, such as IRAs.

Consider where investments are located to help enhance after-tax returns.

	Tax treatment of expected returns	Taxable	Tax deferred	Tax exempt
Tax-free municipal securities and municipal mutual funds	Exempt	M	L	L
Equity securities held long term for growth		M	A	A
Equity index funds/ETFs (other than REITs)	Taxed at long-term capital gain rates	M	A	A
Tax-managed mutual funds and managed accounts		M	L	L
Real estate investment trust (REITs)		L	M	M
High-turnover stock mutual funds that deliver effectively all returns as short-term capital gains	Taxed at ordinary income rates	L	M	M
Fully taxable bonds and bond funds (i.e., corporates)		L	M	M

M More appropriate
 A Appropriate
 L Less appropriate

- 2 Rebalance Even If It Triggers Taxes.** At some point, savvy investors must rebalance their portfolios by using some of the earnings from the better-performing investments to diversify their allocations and manage risk in the portfolio. To minimize the tax impact, start the rebalancing process in tax-deferred accounts such as IRAs or 401(k)s. Then move to the taxable accounts and make as few trades as possible. Remember that the cost of taxes is generally outweighed by the benefits of rebalancing. You can always add new money to underweighted asset classes to help keep your portfolio allocation in balance and not trigger a taxable event.



- 3 **Look to Losses to Offset Gains.** Tax-loss harvesting — selling securities at a loss to offset a capital gains tax liability — may feel counterintuitive because the goal of investing is to make money, not to lose it. However, investment losses are inevitable and, if handled strategically, can potentially improve overall after-tax returns. Any losses not used in the current tax year can be carried forward to be used in future years to reduce your tax bill. The strategy is typically most effective during volatile markets, especially during downturns. The challenge is that a systematic tax-loss harvesting strategy requires disciplined trading, diligent investment tracking and detailed tax accounting.
- 4 **Consider Charitable Gifts.** If you're planning to give charitable gifts, you may experience the tax benefits of your generosity. One way to maximize your charitable giving is to donate securities that have increased in value. Donating appreciated securities enables you to donate more to charity than if you were to sell the stock, incur a capital gain and donate the proceeds. You may donate the securities directly or use a donor-advised fund to let you take an immediate tax deduction, and then make grants to different charities later.
- 5 **Leave a Legacy.** If you're thinking about leaving stocks to your heirs, know that stocks in taxable accounts are generally preferable. Cost basis is calculated based on the market value of the stocks at the time of death rather than at the time they were originally acquired, when they may have been worth substantially less. In contrast, stocks in tax-deferred accounts don't receive this treatment, and distributions are taxed as ordinary income anyway.
- 6 **Keep It Simple.** When it comes to structuring your retirement portfolio for tax efficiency, simplicity can pay off. If you have multiple IRAs and 401(k)s from past employers, consider rolling those accounts into a traditional IRA to defer taxes or a Roth IRA, if you prefer to pay taxes upfront and benefit from tax-free growth. Either way, the fewer accounts the better, because duplicate accounts make it hard to determine the degree to which your investments overlap. Further, it is harder to calculate your annual tax obligation on the earnings. Keeping the number of accounts to a minimum will help you monitor performance and better position you to reallocate as markets fluctuate.

THE BOTTOM LINE

Adopting a tax-efficient approach to your investment strategy can help reduce the negative impact taxes typically have on your portfolio, thereby keeping more of your hard earned money. Talk to a Commerce Trust advisor who can help you choose an investment strategy that can work for your situation, provide tax efficiency and help you achieve your financial goals.

Talk to a Commerce Trust advisor today about tax-efficient investing strategies that support your financial goals.

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