# How to Minimize Your Investment Tax Bill Next Year

## Offsetting gains and other strategies let you hold on to more of your wealth.

By Rebecca Lake, Contributor | May 12, 2017

One important element of minimizing taxes on investments is choosing the right location for individual assets. (Getty Images)

Tax reform is a hot topic now and that could be good news for investors.

President Donald Trump's proposed tax plan would do away with the 3.8 percent net investment income surtax that currently applies to high-income earners. Eliminating the surtax would reduce the top federal tax rate on long-term capital gains to 20 percent for those taxpayers.

While reforming the tax code could bring some relief, it's not guaranteed. If you paid more than you would have liked in taxes on your investments this year, it's not too soon to begin looking ahead to next year's tax bill.

Harvesting investing losses to offset taxes on gains and income, for example, is something that's typically done in December, but there may be other times to consider it.

"In most cases, it's appropriate to harvest losses at the end of the year because you have a clear picture of what your tax circumstances will be," says Robert Waskiewicz, a financial advisor at Wescott Financial Advisory Group in Philadelphia. "However, there are scenarios where harvesting losses makes sense prior to year's end."

Waskiewicz uses dividends and capital gain distributions from mutual funds, which are considered taxable events, as an example.

"If you have a fund that has substantial losses, it may make sense to sell that fund prior to the payment of those dividends or capital gains," Waskiewicz says.

If you're considering harvesting losses before the end of the year, it's important to do so strategically.

"Too frequent trading for the purpose of locking in gains and losses can lead to tax inefficiencies and, therefore, lower net investment return," says George Clough, senior wealth management advisor and senior vice president at People's United Wealth Management in Bridgeport, Connecticut. "Taxable accounts should look to long-term investing as intrinsically more tax-efficient, given the differences between long-term capital gains rates and short-term gains, which are taxed as ordinary income."

Before you harvest losses, first determine how much of a tax offset the sale of a particular asset is likely to yield.

"If you're harvesting losses, start by getting the cost basis on your holdings to figure out if there is a gain or loss with each investment," says Mike Falco, a financial advisor and certified public accountant at Falco Wealth Management in Berwyn, Pennsylvania.

The idea, Falco says, is to break even.

"The main thing to look at when harvesting is what the investment has done," Falco says. "Look at its track record. If it hasn't performed like you expected, get rid of it to offset gains in other investments. It doesn't matter if that's in equities or bonds. Get rid of the dogs."

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Blake Christian, a certified public accountant with Holthouse, Carlin and Van Trigt in Long Beach, California, says investors should review losses on a quarterly basis as part of their tax planning strategy, and consider more regular reviews during periods of market volatility.

"It's extremely difficult to perfectly time the market," Christian says. "If an investor is concerned about an investment they own but think the investment may rebound in the future, one option is to sell half of the shares and retain the other half. This strategy protects half of the investor's assets from further losses and allows upside on the retained shares."

Another important element of minimizing taxes on investments is choosing the right location for individual assets.

"Understanding the tax rules associated with the account holding your investments is crucial," Waskiewicz says.

Waskiewicz says investors need to understand the difference between tax-advantaged accounts and tax-advantaged securities. Qualified accounts, such as individual retirement accounts, 401(k)s and annuities, are tax-advantaged accounts, meaning your investment grows on a tax-deferred basis. Tax-advantaged securities, on the other hand, are designed to avoid taxable events, such as holding assets longer to avoid capital gain distributions or steering clear of dividend-paying stocks.

"Investors want to avoid using tax-advantaged securities within tax-advantaged accounts," Waskiewicz says.

Holding a tax-free municipal bond in an IRA, for example, doesn't make sense because the account itself is tax-free until withdrawals are made. Waskiewicz says tax-advantaged securities should be held in taxable accounts where the full tax advantage is realized.

Michael Repak, vice president and senior estate planner at Janney Montgomery Scott in Philadelphia, says the volatility of your investments influences which type of account they're best suited for.

"There may be holdings in your portfolio that you regularly trim back as they near the top of their trading range and jump back in as they reach their normal bottom," Repak says. "To reduce the tax friction of this trading approach, it makes sense to locate these holdings in a tax-deferred account."

Nick Sloane, president and founder of Sloane Wealth Management in Warrenville, Illinois, says looking into investment alternatives to qualified or non-qualified accounts might make sense for certain investors.

"Many investors in high tax brackets utilize investments such as municipal bonds, which don't have federal tax and are often state income tax-free as well," Sloane says. "These same wealthier folks use a strategy that many middle to upper middle class investors are catching on to."

That strategy, says Sloane, involves putting money into a life insurance policy or even using the policy as an alternative to a Roth conversion. Sloane says that life insurance is frequently a better alternative to a Roth IRA since there are no limits to contributions.

"The proceeds grow tax-free and the income can be taken tax-free, as can a Roth," Sloane says. "On top of that the tax-free death benefits are a form of leveraging and can also provide certain other living benefits."

Giving back can pack an additional punch at tax time if you've fully explored the possibilities of tax loss harvesting and reconsidered your approach to asset location versus allocation.

The tax benefits of giving can be substantial, says Kay McFarlin, president and CEO at TIAA Charitable in Atlanta.

"If you're in the 33 percent tax bracket, a $100 donation to a qualified charity can result in a $33 federal tax break," McFarlin says.

"Instead of giving to charities one at a time, you put your charitable dollars into the fund, enabling you to be eligible for the most favorable current-year tax deductions," McFarlin says. "You simplify your paperwork, benefit from the advantageous tax treatment, give your charitable contributions potential to grow and make a bigger impact with your giving."