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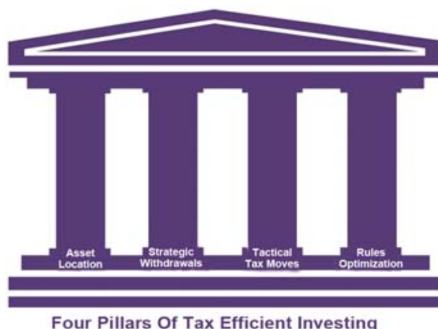
Build On Four Pillars Of Tax-Efficient Investing

It's not the rate of return you realize from investments that really matters—it's how much you pocket after taxes. For instance, suppose you have $10,000 to invest and you're in the 35% federal income tax bracket. If a taxable investment generates a 10% return, your $1,000 in earnings will be reduced to $650 after you pay Uncle Sam. Conversely, if you earn an 8% return on a tax-free $10,000 investment, you walk away with $800—or $150 more. And that doesn't even count state income taxes.



Four Pillars Of Tax Efficient Investing

That's not to say you should sink all of your money into investments providing tax-free income, but it does make sense to be "tax-efficient." That's especially important in the wake of several new tax-law changes affecting upper-income investors.

Start by analyzing the current tax landscape. (We'll limit the discussion here to federal income taxes.) For 2013, the top tax rate on ordinary income rises from 35% to 39.6%, while the usual 15% tax rate on long-term capital gains and qualified dividends jumps to 20% for investors in the top tax bracket. Also, a new 3.8% Medicare surtax may apply to a portion of your "net investment income." At the other end of the tax scale, the two lowest brackets are 10% and 15%, and investors in these tax brackets owe zero tax on long-term capital gains and qualified dividends.

Once you've grasped the fundamentals, concentrate on these four pillars of tax-efficient investing for building and modifying your portfolio:

1. Asset allocation. The main question seems simple enough: Where should you put your assets for optimal tax performance? The answer isn't quite as easy, and it can vary depending on your situation, but consider some basic guidelines.

Try to use the lower tax brackets to absorb as much of your ordinary income or capital gains as you can. For example, if you expect your income to dip this year and you land in the 15% bracket, you might want to realize long-term capital gains qualifying for the 0% tax rate. Meanwhile, you may generally want to consider holding bonds that generate ordinary income in tax-protected retirement accounts, while keeping stocks that might produce gains or losses in taxable brokerage accounts. Your capital losses can offset capital gains plus up to $3,000 of ordinary income.

2. Drawdown strategies. Not only does asset location matter; your tax results also depend on what investments you tap first. Normally, you won't want to draw down retirement plan or IRA distributions before age 59½, because that would likely cost you a 10% penalty tax on top of being taxed at ordinary income

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Rebalancing Plays An Important Role In Producing Returns

The U.S. equity market has more than doubled in value over the past few years. Has your portfolio been rebalanced to take this change into account?

Diversification and asset allocation require periodic rebalancing. That's because 90% of returns are attributable to asset class choices rather than to specific securities.

Let's say your portfolio originally contained 50% U.S. stocks, with the rest split among bonds, real estate, and other alternatives. Between March 2009 and March 2013, the Dow Jones Industrial Average of U.S. stocks rose 129%, following the historic downturn of 2008. If you haven't made any adjustments, the value of the stocks in your portfolio likely has risen well past 50% of the overall value.

It's important to bring that share back down because that increased emphasis on equities has added risk to your portfolio. Stocks eventually will have a down year, and if they make up too great a share of your portfolio your losses could be proportionally higher than what you expect when the market drops.

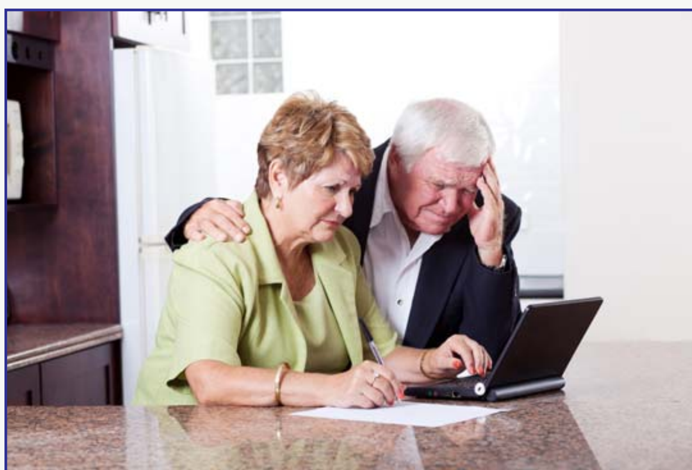
When it comes to portfolio design, getting the recipe right is more important than the ingredients you choose. We will help you get the right mix of asset classes and ensure that your portfolio is rebalanced regularly to keep that mix intact, while taking into account your risk tolerance, changing situation, and the need to keep investment costs low.

Colleen & Rob

How To Bridge A Retirement Shortfall

Suppose you've scrimped and saved for retirement but you still haven't met your goals. Or perhaps an illness or a business venture that went south has exhausted your discretionary funds. Or maybe you just didn't count on costs rising so quickly. In any event, you're standing on the precipice of retirement, but you don't think you'll have enough to live comfortably for the next 20 or 30 years. These four practical suggestions might help:

1. Relocate to a less expensive home. According to the Social Security Administration, housing is the largest component of living expenses for people over age 55, accounting for 35% of the cost pie. One of the best ways to save money during retirement may be to downsize your home. Do you really need that rambling four-bedroom colonial in which you raised your kids? You probably do not.



And it's not just size that matters. You might consider moving to a location where the climate is agreeable and the costs are lower than what you're currently paying. Just don't forget to factor in state income taxes and other taxes. For the adventurous, a move out of the country could be an option.

Here's another thing to add to the equation if you're considering relocation—it's usually less expensive for people to live together than alone. A recent study by the Pew Research Center, based on 2011 Census Bureau data, reveals that the number of Americans living in multi-generational family households increased 4.9 million from 2007 to 2009. You could move in with your children, pay your share of the housing costs, and still come out ahead.

2. Refinance your mortgage. With interest rates at historic lows, now's a good time to refinance an existing mortgage if you don't plan on moving anytime soon. If you can cut your monthly bill by hundreds of dollars or more, it won't take too long to recoup the refinancing costs.

3. Figure out your bottom line. Budgeting isn't exciting, but making realistic projections of your likely expenses in retirement can be crucial. Frequently, costs for life insurance and spending on children will disappear as you move closer to traditional retirement age, only to be replaced by travel expenses or other new costs.

4. Go to work part-time. Being "retired" doesn't mean you have to quit working completely. The job market for seniors has been improving, with the Bureau of Labor Statistics showing a 5.6% unemployment rate for those 55 and older in February 2013, compared with 6.1% the year before. Getting a paycheck, even a relatively small one, can remove some of the pressure and supplement your income from investments, Social Security, and distributions from retirement plans.

Finally, take stock of your situation while you're still employed full-time. Planning ahead is the best solution for bridging a potential retirement shortfall. ●

Gimme Tax Shelter! Find It At Home

Despite recent tax law changes that have chipped away at some of the benefits, a home remains a top tax shelter for homeowners, as well as a prime investment opportunity. Let's briefly review the basics.

Current deductions: The tax law generally allows you to deduct property taxes on a home you own as well as mortgage interest paid on the first $1 million of debt used to acquire the home. In addition, you may be able to deduct the interest on up to $100,000 of home equity debt, regardless of how you used the proceeds (when permitted by state law). These deductions may offset some of the everyday expenses of owning a home.

However, certain itemized deductions—including those for property taxes and mortgage interest—now are reduced by 3% of the amount of adjusted gross income (AGI) exceeding $250,000 for single tax filers, and $300,000 for joint filers (but the reduction can be no more than 80% overall).

Home sale exclusion: If you've owned and used your home as your principal residence for at least two of the past five years, you can exclude from your income up to $250,000 of your profit from selling it if you're a single filer and $500,000 if you're a joint filer. There is no limit on the number of times you can claim this exclusion during your lifetime. When you're forced to sell before you qualify due to a change in employment, for health reasons, or because of other unforeseen circumstances, you may be eligible for a partial exclusion.

Any excess gain is taxed at capital gain rates. The maximum tax rate on a long-term capital gain is currently 15%, increased to 20% for single filers with taxable income above $400,000 and $450,000 for joint filers.

Home improvements: As mentioned earlier, you may deduct

Remarrying In Your 50s? 7 Key Aspects

Jack Webster had given up on romance after his marriage splintered five years ago. His two children were now both in college. Rhoda Seaver, divorced with three teen-aged children, also was skeptical about diving back into the dating pool. But Jack and Rhoda found each other through a dating service and now are engaged to be married.

It's not an uncommon story. According to the Census Bureau, more than 50% of the divorced males in this country over age 50 and more than 40% of the divorced females in the same age bracket end up remarrying. But there's more to creating a union late in life than just melding family units. Several important financial considerations may be difficult to resolve for soon-to-be retirees. Here are seven issues that could cause problems:

1. Social Security and pension benefits. If you're divorced, getting remarried generally will suspend your right to receive Social Security benefits based on your ex-spouse's earnings record. Similarly, if you're widowed and plan on collecting benefits based on your deceased spouse's record, you may have to wait until age 60 to remarry. (Getting married again also could affect the amount you're entitled to from a former spouse's pension plan. Contact the pension plan administrator to determine the impact of remarriage on benefits.)

2. Marriage penalty. Because of the way federal income tax rates are structured, some couples are hit with a "marriage penalty" if both have substantial incomes. In other words, filing a joint return will produce greater tax liability than they would have to pay if they continued to be single filers. That problem has been exacerbated by the 2013 tax law and its new top income tax rate of 39.6%.

3. Estate planning. It's always crucial to have a valid will in place so that your heirs won't have to depend on state law to dictate where assets will go. That's even more important if you're remarrying. You'll certainly need to revise an existing will as well as being sure to update beneficiary designations for retirement plans, because those supersede your will. Moreover, even if your will says your home will go to children from a prior marriage, it will go to your new spouse if the two of you own it jointly with rights of survivorship.

4. College financial aid. Will a new marriage in your 50s affect the financial aid your children are entitled to when attending college? To determine financial aid awards, the government looks at the income and assets of the "custodial parent"—the one with whom a child has lived for most of the preceding year—but such calculations also may reflect income and assets of a new spouse when the custodial parent remarries. Your intended's wealth indeed might reduce your child's college aid. (Some colleges also include the noncustodial parent's assets in the equation.)

5. Health-care expenses. Your state may impose special rules relating to payments of medical expenses, and the rules for nursing home care could be particularly significant. Typically, if someone requires nursing home care, it may be possible to transfer some of that person's assets in attempt to qualify for assistance under Medicaid (subject to certain imposing restrictions). However, in some states, you may still be responsible for the costs of a spouse, even if the spouse has transferred assets out of his or her name. Such rules could affect your financial arrangements with a new husband or wife.

6. Alimony. If you receive alimony from your ex-spouse, it likely will come to a halt when you remarry, though remarriage generally doesn't affect child support. Consider how this will affect your family's lifestyle. Figure out whether you still will be able to afford some of the luxuries you enjoy now or whether you'll have to scale back. Look at options for replacing the lost income.

7. Beneficiary designations. When you get remarried, it's common practice to change the designated beneficiary (or beneficiaries) on insurance, retirement plan accounts and annuity contracts (see #3). Don't forget to do this. If you fail to do this, an ex-spouse might be entitled to most or all of such benefits.

It's only prudent for Jack and Rhoda to consider these financial issues before saying "I do." Other considerations, such as whether to use joint checking accounts or a prenuptial agreement, also may come into play. Having an open discussion before you remarry may avoid problems that could fester later. ●

interest on loans used for home improvements, based on the limit for home equity debt. Also, if you make an improvement for medical reasons (for example, installing a pool to help alleviate a child's asthma), the increase in the home's value is added to your other deductible medical expenses (plus any annual costs). And you may claim a 10% credit for qualified energy-saving improvements up to a maximum of $500.

Rental properties: When you own a home as a rental property, you're entitled to deduct depreciation plus other expenses attributable to the rental activity, such as insurance, repairs, property taxes, mortgage interest, etc. These deductions can help offset tax on the rental income you receive. Note that special rules apply to a "vacation home" you rent to others but that also is used personally. If your personal use exceeds the greater of 14 days or 10% of the days the home is rented out, you can't claim a loss for the year. Other special rules may apply.

Of course, this is only a broad overview. Obtain more details on all the tax breaks of home ownership from a tax professional. ●

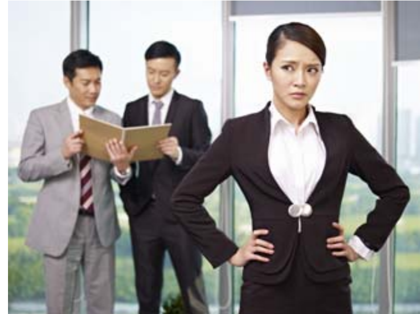
5 Ways To Handle Problem Employees

Do you have one or more "problem employees" at your company? You may have inherited them from a prior administration or maybe you didn't vet them properly during the hiring process. Now they're firmly entrenched and it appears there's little you can do short of firing them and risking a lawsuit for wrongful termination or discrimination. And even though dealing with these workers saps your energy, you may still rely on them for vital business functions.

Nevertheless, you don't have to close your eyes, shut your ears, and accept the status quo. Here are five steps that could help alleviate disruptions in your workplace:

1. Start by spelling out, in your employee manual, the company's position on negative behavior. In particular, focus on the disruptive acts that simply will not be tolerated. This could include hostility, bullying, berating, intimidation, making unfounded accusations, and worse. When you distribute the updated manual to employees, have them verify in writing that they have received it and that they understand the consequences of any violations.

2. Identify the employees who are causing problems. This doesn't mean you should single out every person who has unleashed a tirade or engaged in an isolated incident. Virtually everyone—including you—is entitled to have a bad day now and then. Concentrate on those employees who have exhibited a regular pattern of disruptive behavior.



3. Schedule meetings with the worst offenders. Frequently, employees will be surprised to find out you consider them a problem. While keeping the discussion informal, try to get to the heart of the reasons for the disruptions. (It's not always the employee's fault.) If the worker presents valid points, address them swiftly. Rely on the company manual as a guideline.

4. Don't drop the ball after the meeting, even if it was a productive one. Continue to monitor the employee's progress for at least a year. If you've agreed on a path to follow, give the worker time to develop better habits. You can't expect all problems to go away overnight. Keep notes in the person's personnel file tracking signs of improvement and slip-ups.

5. If all else fails, initiate formal disciplinary action against the employee according to the procedures outlined in your manual. Typically, this will involve a system of verbal warnings, then written warnings, and, finally, suspension or even termination.

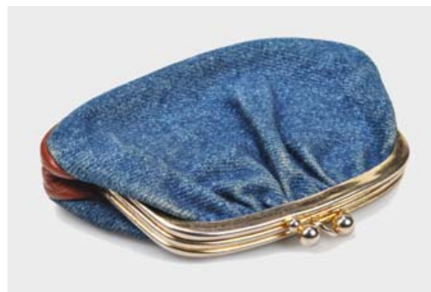
Don't allow problems to fester—before you know it, your entire workplace could be infected. If you can take an aggressive approach to resolving such issues while remaining sensitive to everyone's feelings, your business will be better for it. ●

Tax-Efficient Investing

(Continued from page 1)

rates. After age 59½, Roth IRA distributions may be completely tax-free, but you still might prefer to keep those assets intact for your heirs. (Roths don't require mandatory distributions during your lifetime.) Other decisions about drawdowns may depend on several tax-related factors. It may be advantageous for you to receive taxable brokerage account distributions in a year in which you expect to be in a low tax bracket and below the threshold for the 3.8% Medicare surtax.

3. Tactical tax planning. Your approach to tax-efficient investing will typically reflect various aspects of your financial plan as well as applicable tax factors. Frequently, your situation will dictate that you harvest capital losses at year-end to offset capital gains. Or you might do the opposite if you have prior losses that will soak up any capital gains you harvest now. Another idea is to use tax-sheltered life insurance as a planning device. The objective is to put a sizable dent in your overall tax liability.



4. Incentive-based tax planning. Finally, your plans should incorporate ways to take advantage of tax-based incentives in the law. One prime example is to convert traditional IRA funds into a Roth IRA—in effect, paying a conversion tax up-front in return for tax-free benefits in the future. Other techniques are designed to squeeze through tax loopholes that apply to qualified dividends, master limited partnerships (MLPs), leveraged real estate acquisitions, charitable trusts, and oil and gas deals, just to name a few possibilities.

Tax-efficient investing is not a one-size-fits-all proposition, so you'll need to tailor your strategies to your own specifications. Nevertheless, you can lean on these four pillars as a solid foundation. We can help you build a tax-efficient investment plan. ●

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