“Tax Smart Diversification”

How do you win the “Tax Game”? Consider utilizing a “Tax Diversified Approach” to address your total investment strategy. In general, there are four types of tax investment holdings.

1. Investments that are funded with after tax income and are taxed each year based upon capital gain or income tax rates. This would include stocks, mutual funds, CDs, savings accounts, etc…
2. Investments that are funded with pre-tax dollars and grow tax deferred until withdrawal. At withdrawal, they are fully taxed. This would include traditional IRAs, 401Ks, most pension plans, etc…(Withdrawals prior to age fifty nine and a half may be subject to a 10% federal penalty tax.)
3. Investments that are funded with after tax dollars and grow tax deferred until withdrawal then can be withdrawn tax-free. Examples could include Roth IRAs (Distributions on earnings tax free after age fifty nine and a half. If held for at least 5 years. Prior to age fifty nine and a half a 10% penalty tax may apply.), some municipal bonds, and properly structured permanent life insurance.
4. This fourth category represents everything else. Example: real estate, businesses, etc…

Each of the holdings provides advantages over the other options and maintains certain restrictions and disadvantages. The key is to diversify your holdings to receive the tax benefits yet manage it appropriately to control the downside risk. A common mistake is to hold the majority of assets in only one of the four categories. This provides little control or options at time of distribution. A preferred strategy is to have balance or tax diversification and to provide control based upon what the future capital gains rate, income tax rates, social security and Medicaid/Medicare limits may be. This allows you to win in the “end game” which may be more important than the short term tax deduction that most individuals seek.

A well diversified tax strategy for example would be to have a retirement nest egg with significant holdings in each tax category. Then whatever the IRS determines tax rates to be, you will have options to withdraw from the lower net tax category.
We are certain that the tax rates and percentage amounts will change over time. They tend to change with new presidential administrations, a new Congress and socio-economic changes. With proper tax diversification, you will maintain more flexibility thereby allowing you to be “tax smart” with options and choices.

INVEST Financial Corporation does not provide tax advice. Please consult your tax advisor for guidance on your particular situation.

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