Some Last-Minute Tax-Smart Investment Strategies to Help Boost Your After-Tax Rate of Return

As 2019 winds down, there is still time to reduce your potential tax obligation. Dentists who have investments in retirement or non-retirement accounts have plenty of questions about how to use year-end tax planning to help boost their after-tax rate of return.

What can dentists do to increase their after-tax rate of return on investments before the end of the year?

- ***You should get yourself familiar with the latest tax laws and strategies by reading through the second edition of my book,*** *Financial Independence (Getting to Point X): A Comprehensive Tax-Smart Wealth Management Guide,* focusing on the ***tax alpha strategies*** provided at the end of each chapter.
- Chapter 9 of my book is titled **"Managing Your Investments"** and focuses on how these tax-smart strategies may increase your after-tax rate of return on investments.
- It is important to remember that ***<u>99% of the steps you need to take</u>*** to reduce your 2019 tax bill must be implemented ***<u>before December 31</u>***. ***This means you only have a few weeks left to implement these strategies.***

How can a dentist take advantage of tax-loss harvesting?

- You should consider selling some of your investments in stocks, bonds, or mutual funds that have declined in value from when you originally purchased them ***through your non-retirement accounts.*** To ***<u>realize these capital losses,</u>*** you must complete the transaction before December 31. Capital gains can be offset to capital losses to the extent of gains, and an additional $3,000 in capital losses can be used to offset your ordinary income. Any excess loss above this amount can be carried forward to future years. ***The big hurdle this year is trying to identify unrealized losses since most investment classes have done very well this year.***
- It is very important to remember that if you sell off a security at a loss, you cannot repurchase it for at least 30 days. Otherwise, you would lose the benefit of taking a loss as a result of the ***<u>wash sale rules</u>***.

If a dentist is taking advantage of tax-loss harvesting, should they immediately purchase a mutual fund to replace it before the end of the year?

- It is important to note that if you are selling off investments from your non-retirement accounts in December, do not make the mistake of ***<u>buying</u>*** a mutual fund that will pay out a large ***<u>capital gain distribution</u>*** before the end of the year. In some cases, it may be best to sell some losers before December 31, but do not buy back a mutual fund until after the dividend record date (***<u>this is called the x dividend date</u>***).

Many dentists take advantage of rebalancing their portfolio based on an asset allocation model. How does this work with a strategy of *asset allocation by location*?

- One of the major advantages of using rebalancing as an investment strategy is that it provides you with a disciplined approach to taking profits from some of your winners, allowing you to cash in on these gains.
- Combining this with an ***"asset allocation by location"*** strategy could allow you to increase your true after-tax rate of return without added risk. Do not utilize the identical asset allocation to invest your non-retirement and retirement funds. This one-size-fits-all approach could cause you to pay excessive income taxes, reducing your true after-tax rate of return. ***You may have the right overall asset allocation model, but you may be putting your selected investment classes in the wrong location (retirement vs. non-retirement accounts).***
- Wherever possible, you want to include tax-favored investment asset classes in non-retirement accounts.
- For example,
    - Long-term capital gains and qualified dividends are taxed at a lower rate in non-retirement accounts.
    - You cannot take advantage of tax-loss harvesting in a retirement account.
    - Corporate bonds are taxed at ordinary income tax rates, so they would be more suitable in a retirement account.
    - You never want to include municipal bonds in a retirement account, since this could make a tax-free investment taxable.
- By implementing an ***asset allocation by location strategy***, you may be able to increase your after-tax rate of return without any additional risk. ***This is the definition of tax alpha.***

What is the difference between long-term and short-term capital gains?

- If you hold an investment for more than a year, you will have the added advantage of ***<u>long-term capital gains treatment</u>***. This could mean that high-income earners could pay 20% instead of 37% on their capital gains. For dentists with lower income who are in the 12% tax bracket, it could be the difference between paying 0% or 12% on their capital gains.
- Long-term capital gains tax rates still remain as they were under the previous tax law, which includes a 0% tax rate, a 15% tax rate, and a 20% tax rate. **Always check the holding period of your investments before placing a sell order.**

How can using specific identification help reduce a dentist's tax bill?

- Keep an accurate record of all stock transactions, along with when you bought them, especially if you purchased stock in the same company at different times.
- By using ***<u>specific identification</u>***, you may be able to control the amount of gain or loss on the sale or part of your investment holdings. You are required to make an adequate

identification, typically by ***giving your broker specific instructions*** of which tax lot is to be sold. This must be communicated to you in writing through the brokerage firm.

How can a dentist be sure they are maximizing their after-tax rate of return on investments?

- You **should work with an investment advisor who is thoroughly familiar with the tax laws and strategies** that will maximize your true rate of return. We all try to increase our rate of return in pre-tax dollars, but far too many dentists neglect to focus on the easiest way to create a higher after-tax rate of return on their investments.
- By using **tax-smart investment strategies**, you may be able to increase your after-tax rate of return by 1 or 2 percentage points without taking on any additional risk. ***This is the definition of tax alpha!***

There are a lot of nuances in the tax code affecting each of these end-of-year moves. Don't hesitate to get in touch if you need advice.

I would like to wish you and your entire family a happy and healthy holiday, as well as a prosperous new year.