

Investment Insight: 10 Tax Smart Strategies



*Qualified tax deductions aren't the only way to reduce your tax obligation. Consider these strategies to help you keep more of what you earn.**

Trying to trim your tax bill? If so, here are 10 tax-smart strategies to consider:

1. **Buy securities with long-term capital gains potential.** The tax savings may be significant. Long-term capital gains are defined as gains from assets held for more than one year. In 2011 and 2012, the tax rate on this type of holding is just 15 percent for most investors, i.e. taxpayers in the marginal tax brackets 25% and higher.¹ By contrast, the tax rate on short-term gains and payouts from investments that are taxed at your ordinary income tax rate (regardless of the holding period) may be as much as 35 percent. The long-term capital gain tax rate for those in lower tax brackets (10% and 15%) is 0% for 2011 and 2012.

2. **Buy stocks that pay qualifying dividends.** Qualifying dividends are dividends paid by most U.S. companies and so-called qualified foreign corporations.² They are taxed at the same rate as your long-term capital gains rate. (Other dividends are usually taxed at your ordinary income tax rate). Be aware that certain requirements must be met in order to enjoy tax savings from qualifying dividends.

3. **Consider buying tax-exempt vehicles such as municipal bonds.** Once upon a time, tax-exempt securities like municipal bonds were appropriate only for the wealthy. But that has changed. Mid-income investors now find them attractive due to their tax advantage. To determine whether tax-exempts are appropriate for your tax bracket, identify the yield you would have to earn from a taxable instrument to equal the yield on a tax-exempt investment with the same credit rating and maturity date. I will be glad to make the calculation for you.

4. **Consider taking losses on under-performing investments.** Sell them to offset capital gains. Trim your tax bill by selling an investment whose current value is less than its purchase price. Subtract the loss from capital gains that you receive on other investments. You can deduct up to \$3,000 in losses in one year and use losses in excess of that amount in future years.

5. **When taking a loss, be wary of the wash sale.** A wash sale is the process of selling a security at a loss for tax purposes and buying it back within 30 days. IRS rules require investors to wait more than 30 days before repurchasing the security to take the loss.

6. **Don't forget to invest in your IRA.** Both the Traditional and Roth IRA offer significant tax-saving benefits. With a Traditional IRA, earnings grow tax-deferred, and, depending on your financial eligibility, contributions may be tax-deductible.

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The complexities of building, preserving and passing along wealth have never been greater. Affluent investors are increasingly seeking guidance and comprehensive solutions that consider their unique circumstances and long-term goals. It's my pleasure to work with such individuals to offer insight, advice and solutions in helping them reach their goals.

With a Roth IRA, earnings are tax-free when you begin taking payouts, provided certain conditions are met.

7. Consider annuities. Once you've already invested the maximum amount allowed in your employer's retirement plan at work, and an IRA in your private investment career, what next? To shield more income from taxes, consider annuities. Why? With an annuity, earnings grow tax-deferred until withdrawn. Annuities come in two types: fixed and variable. A fixed annuity is a conservative choice in that you receive a fixed yield for a set period. With a variable annuity, returns vary from year to year, based on portfolios that you select, but you can alter your strategy as needs and/or risk tolerance change.

8. Consider 529 Plans for college expenses. These state-sponsored plans can help you sock money away for projected education costs, your own or your child's. Earnings grow tax-free, and as long as they are used to pay qualified higher education costs, can also be withdrawn free from taxes. Note: Earnings not used for higher education expenses are subject to taxation and a 10% penalty.

9. Know which investments are best held in taxable accounts. Given low tax rates on qualifying dividends, stocks and other assets held more than one year, hold these securities in taxable accounts so you can take full advantage of the tax savings. If you own these securities in tax-deferred accounts, you lose the tax benefit because withdrawals are taxed as ordinary income.

10. Know which investments are best held in tax-deferred accounts. Securities that generate gains or income subject to ordinary income tax rates (e.g., taxable income securities, such as corporate and government bonds) are generally best held in tax-deferred accounts. Why? You can at least delay paying taxes on the gains and/or income from these securities until you withdraw them from the account.

A Final Word

Before deciding to pursue any of these tax-smart ideas, make sure that they fit well with your overall financial plan. I can help you decide which investment may complement your portfolio, but you should consult your attorney or tax advisor regarding your specific circumstances.

Sources

1. The rate is 0% for taxpayers with income in the 10% or 15% tax brackets.
2. An example of a qualified foreign corporation is one located in a country that has a tax treaty with the United States.

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