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Tax Strategies for the Savvy Investor

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There is a saying in the investment advice world: "Don't let the tax tail wag the investment dog." Investors that take a focused view of tax implications of their investment strategy often make decisions that may hurt a long-term plan of making money. It reminds me of how my father would refuse to sell a stock that was up from where he bought it since he "would have to pay tax on the gain." I thought that is why you buy the investment in the first place.

It's often best to seek advice from your certified public accountant (CPA) or tax advisor and attorney about tax decisions. It is also important to communicate your current and future tax considerations to your financial advisor. Often, an advisor with a certified financial planner (CFP) designation has had training in this exact sort of planning.

Here are a few strategies that you can consider if they apply to your investment and tax situation.

Give Appreciated Assets to Charity

One great benefit of passing assets to others is that there are a few ways of doing so that could minimize the tax implications to all involved. If you move appreciated stock or other assets to a charitable foundation or give them directly to a charity, you will not have to pay tax on the gain.

In addition, you can receive some potential tax deductions on your own personal return. If you are in need of replacing this value so your beneficiaries still have a pot of money from your lifetime of accumulation, consider a life insurance policy to replace that value. The death benefit received by your beneficiary is often received free of tax. If you are less inclined to use a charity, you can still pass them on at your death and the asset will receive a step up in cost basis to the value of the asset at your date of death.

Gain By Selling Losers

Not selling a stock that is up in value just to avoid paying the tax is akin to not selling your stock that is down and hoping it comes back so you don't lose. The savvy strategy would be to sell your losers and move the money into other areas that could be better positioned to make money. You could also offset the winner that you actually did sell by selling the loser that didn't work out so well. Thus, your tax situation could improve by taking a loss and swapping into another investment

Be careful if you buy or sell the same investment again within a 30 day period. This involves consideration with the wash-sale rule that the IRS has in place. If you work this process in the right manner, you should be in a position to build a diversified group of holdings that you plan to hold for more than 12 months. This creates a better long-term situation for your overall portfolio since you can take advantage of the long-term capital gains rules that are written in the IRS code.

Make the Most of Tax Savings in Retirement Plans

One of the best gifts we have been given by the IRS is the Roth IRA. What can be better than tax free money in retirement? A backdoor IRA is now a common planning tool that can be used for those with income above certain limits that are unable to contribute to the Roth directly.

Other IRAs and deferred compensation plans offered at your job may be an important long-term planning tool. High income wage earners and executives may have access to supplemental retirement plans (often know as a SERP). Those with small businesses can set up profit sharing plans integrated to benefit the owner as well as reward employees. Money within these retirement plans will defer any tax on gains until withdrawn, usually after the age of 59.5.

Any time of year is a good time to plan for your tax situation. The end of the year is an especially important time to do so as many of the strategies discussed here (among many others) are important to complete by December 31 of each year.

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