

Tax Efficient Investing

Presented by
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- It's not what you earn, it's what you keep
- There can be large difference between gross returns and net after-tax returns
- There may be a conflict of interest for advisors who's performance is generally based on pre-tax net of fee performance – perception vs. reality
- Elements of Tax Efficient Investing
 - Considering after-tax sales proceeds
 - Extending holding period from short-term to long-term
 - Understanding taxable threshold levels
 - Tax loss-harvesting **throughout the year**
 - Specific lot identification
 - Tax-aware research process
 - Tax-aware investment selection/manager selection

- Client-specific situation need to be considered
- Never let the “tax tail wag the dog”
- This presentation focuses on mutual funds, but the principles apply to all type of investment



Tax Overview

Individual income above...	Couple's income above...	Income "type"	Ordinary Income	AMT rate	L/T gains & qual. dividends	Wage earned income	Self-employed earned income	Net inv. income	Itemized deduction phaseout (Pease)	Personal exemption phaseout (PEP)*	AMT exemption phaseout
\$0	\$0	Taxable	10%	26%	0%	7.65%	15.30%	0%	0%	0%	0%
\$8,950	\$17,900	Taxable	15%								
\$36,250	\$72,500	Taxable	25%								
N/A	\$113,700	Earned	28%	28%	15%	0% / 1.45%	0% / 2.9%	0%	0%	0%	6.5% / 0%
\$87,850	\$146,400	Taxable									
\$112,500	N/A	AMTI	33%	28%	15%	1.45%	2.90%	3.80%	0%	0%	6.5%
\$113,700	N/A	Earned									
N/A	\$150,000	AMTI									
\$175,000	\$175,000	AMTI	33%	28%	15%	2.35%	3.80%	3.80%	1%	1%	7%
\$183,250	\$223,050	Taxable									
\$200,000	\$250,000	Earned									
\$200,000	\$250,000	AGI									
\$250,000	\$300,000	AGI	35%	28%	20%	2.35%	3.80%	3.80%	1.05%	0% / 1.1%	0% / 7%
\$323,000	N/A	AMTI									
\$372,500	N/A	AGI									
\$398,350	\$398,350	Taxable	39.6%	28%	20%	2.35%	3.80%	3.80%	1.2%	0%	0%
N/A	\$422,500	AGI									
\$400,000	\$450,000	Taxable	39.6%	28%	20%	2.35%	3.80%	3.80%	1.2%	0%	0%
N/A	\$473,000	AMTI									

SOURCE: Michael Kitces



	Marginal Rate
Federal	25.0%
State	5.0%
Sales Tax	3.0%
Payroll Tax	15.3%
Hidden Taxes	1.0%
	<u>49.3%</u>



<u>Filing Status</u>	<u>MAGI Threshold</u>
Joint & Qualifying Widowers	\$250,000
Married Filing Separately	\$125,000
Individual & Head of Household	\$200,000

NOTE:

NIT is the lesser of 3.8% of MAGI over threshold or 3.8% of Net Investment Income



Capital Gains Rate	NIT	TOTAL	If Taxable Income Falls....	Single Threshold	Married Filing Joint Threshold
0.0%	0.0%	0.0%	in the 10% or 15% bracket	\$0	\$0
15.0%	3.8%	18.8%	in the 25%, 28%, 33% or 35% bracket	\$36,900	\$73,800
20.0%	3.8%	23.8%	in the 39.6% bracket	\$406,750	\$457,600
20.0%	3.8%	23.8%	Trusts with income over \$12,150		

NOTE:

- For married filing joint, there is no capital gains if income falls below \$73,800!
- In some cases, it may actually be worthwhile to take gains
- Watch out for gains/income in trusts
- Don't forget about short-term capital gains rates (ordinary income rate)!

Terminal Wealth Given Various Tax Rates
\$100,000 invested over 30 Years
Pretax Rate of 10%

<u>Tax Rate</u>	<u>Final Value</u>
0%	\$ 1,744,940
10%	\$ 1,326,768
20%	\$ 1,006,266
30%	\$ 761,226
40%	\$ 574,349
50%	\$ 432,194



Cost Basis Accounting

Time	Lot #	Dollar Investment	Price	Shares	Ending Value	Long Term Profit/Loss	Short Term Profit/Loss
Q1	1	30,000	80.00	375	37,500	7,500	
Q2	2	10,000	85.00	118	11,765	1,765	
Q3	3	10,000	95.00	105	10,526	526	
Q4	4	10,000	105.00	95	9,524	(476)	
Q1	5	10,000	110.00	91	9,091		(909)
Q2	6	10,000	115.00	87	8,696		(1,304)
Q3	7	10,000	99.00	101	10,101		101
Q4	8	10,000	98.00	102	10,204		204
Ending		100,000	100.00	1,074	107,406	9,315	(1,908)
Average Purchase Price			93.10				

Cost Method	Lot #	Cost Basis	Sale Price	Shares	Sale Proceeds	Long Term Profit/Loss	Short Term Profit/Loss	Potential Maximum Tax	% of Proceeds to Tax
FIFO	1	6,400	100	80	8,000	1,600		380.80	4.8%
Average Cost	N/A	7,448	100	80	8,000	552		131.30	1.6%
Specific Lot	6	9,200	100	80	8,000		(1,200)	(520.80)	-6.5%



Tax Cost for Mutual Funds

Mutual Fund Distributions

PIMCO Fundamental IndexPLUS AR Fund

Average Annual Total Returns (for periods ended 12/31/12)

	1 Year	5 Years	Since Inception (06/30/2005)
Institutional Class Return Before Taxes	26.86%	9.07%	9.80%
Institutional Class Return After Taxes on Distributions ⁽¹⁾	20.74%	2.32%	4.08%
Institutional Class Return After Taxes on Distributions and Sales of Fund Shares ⁽¹⁾	17.23%	3.42%	4.79%
Class P Return Before Taxes	26.62%	8.93%	9.66%
Administrative Class Return Before Taxes	26.55%	8.77%	9.51%
Class D Return Before Taxes	26.42%	8.62%	9.35%
Class A Return Before Taxes	21.80%	7.79%	8.80%
Class C Return Before Taxes	24.38%	7.81%	8.56%
S&P 500 Index (reflects no deductions for fees, expenses or taxes)	16.00%	1.66%	4.61%
FTSE RAFI® US 1000 Index (reflects no deductions for fees, expenses or taxes)	17.21%	3.70%	6.03%
Lipper Large-Cap Core Funds Average (reflects no deductions for taxes)	15.02%	0.83%	4.08%

Mutual Fund Distributions

PIMCO International StockPLUS AR Strategy Fund

Average Annual Total Returns (for periods ended 12/31/12)

	1 Year	5 Years	Since Inception (11/30/2006)
Institutional Class Return Before Taxes	29.36%	1.92%	4.03%
Institutional Class Return After Taxes on Distributions ⁽¹⁾	26.00%	-1.64%	0.34%
Institutional Class Return After Taxes on Distributions and Sales of Fund Shares ⁽¹⁾	19.09%	-0.55%	1.20%
Class P Return Before Taxes	29.29%	1.86%	3.97%
Administrative Class Return Before Taxes	29.91%	1.80%	3.88%
Class D Return Before Taxes	28.92%	1.56%	3.60%
Class A Return Before Taxes	23.88%	0.74%	2.95%
Class C Return Before Taxes	26.86%	0.78%	2.85%
MSCI EAFE Net Dividend Index (USD Unhedged) (reflects no deductions for fees, expenses or taxes)	17.32%	-3.69%	-0.84%
Lipper International Multi-Cap Core Funds Average (reflects no deductions for taxes)	17.68%	-3.60%	-0.80%

PIMCO Commodity Real Return

Average Annual Total Returns (for periods ended 12/31/12)

	1 Year	5 Years	10 Years
Institutional Class Return Before Taxes	5.31%	-0.85%	7.67%
Institutional Class Return After Taxes on Distributions ⁽¹⁾	4.04%	-6.11%	3.20%
Institutional Class Return After Taxes on Distributions and Sales of Fund Shares ⁽¹⁾	3.51%	-3.80%	4.00%
Class P Return Before Taxes	5.24%	-0.93%	7.57%
Administrative Class Return Before Taxes	4.88%	-1.13%	7.38%
Class D Return Before Taxes	4.87%	-1.34%	7.13%
Class A Return Before Taxes	-0.95%	-2.46%	6.52%
Class B Return Before Taxes	-0.97%	-2.27%	6.48%
Class C Return Before Taxes	3.13%	-2.07%	6.34%
Class R Return Before Taxes	4.51%	-1.73%	6.60%
Dow Jones-UBS Commodity Index Total Return (reflects no deductions for fees, expenses or taxes)	-1.06%	-5.17%	4.09%
Lipper Commodities General Funds Average (reflects no deductions for taxes)	-3.43%	-6.95%	3.72%

iShares Website

iShares ETFs Capital Gains Distributions

Tax efficiency is a key component to an ETF's total performance.

iShares offers experienced Portfolio Management and Index Research groups that constantly assess the risk and tax consequences of each transaction to help reduce risk and maximize tax efficiency. Delivering on our reputation for low cost and tax-efficient investments is integral to every decision we make.

Our results are measurable. This year 294 iShares ETFs did not distribute capital gains.




For the 4 iShares ETFs that distributed capital gains, please see the table below.

2013 Capital Gains Distributions

Fund Name	Short Term Gain (\$/share)	Long Term Gain (\$/share)	Total Distributions (\$/share)	Total Distribution (% of NAV)	Ex-Date	Pay Date
iShares Core Total U.S. Bond Market ETF (AGG)	-	0.01	0.01	0.01%	12/2/2013	12/6/2013
iShares 10+ Year Credit Bond ETF (CLY)	0.05	0.03	0.08	0.15%	12/2/2013	12/6/2013
iShares International Preferred Stock ETF (IPFF)	0.10	-	0.10	0.39%	12/2/2013	12/6/2013
iShares Morningstar Multi-Asset Income ETF (IYLD)	0.04	-	0.04	0.17%	12/3/2013	12/9/2013

 Print  Email  Feedback

Additional Resources

-  [Tax Essentials](#)
-  [Historical Distributions - All iShares Funds](#)
-  [Tax Strategies](#)

Fund	Ticker	Pre-tax 10-Year
PIMCO Real Estate	PETAX	11.1%
Vanugard REIT	VGSIX	8.8%

Fund	Ticker	Post-tax 10-Year
PIMCO Real Estate	PETAX	3.7%
Vanugard REIT	VGSIX	8.7%

Note: For Period Ending February 28, 2014

Fund	Ticker	Pre-tax 10-Year
Templeton Emerging Market	TEEMX	9.2%
Fidelity Emerging Market	FEMKX	9.2%
Fund	Ticker	Post-tax 10-Year
Templeton Emerging Market	TEEMX	6.0%
Fidelity Emerging Market	FEMKX	8.7%

Note: For Period Ending February 28, 2014

Morningstar Website

Fidelity Floating Rate High Income FFRHX | ★★★ | Bronze



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Compare

Tax Analysis

	1-Mo	3-Mo	6-Mo	YTD	1-Yr	3-Yr	5-Yr	10-Yr	15-Yr	Since Inception
Pretax Return										
FFRHX	0.25	1.06	2.37	0.74	3.84	3.88	8.07	4.54	—	4.76
Tax-adjusted Return *										
FFRHX	-0.86	0.56	1.52	0.50	2.29	2.50	6.67	2.93	—	3.18
% Rank in Category	65	53	50	32	54	72	94	3		—
Tax Cost Ratio										
FFRHX	—	—	—	—	1.49	1.33	1.29	1.54	—	—
Potential Cap Gains Exposure										
FFRHX	0.61									

(02/28/2014)

Currency is displayed in USD.

* Post tax returns are load adjusted.

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Tax Loss Harvesting

iShares S&P 500 (IVV) – 2010 Prices



iShares S&P 500 (IVV) – 2010 Prices

	<u>Price</u>	<u>Date</u>	<u>% Change from Beginning</u>
Beginning	\$ 113.65	January 1	0%
Minimum	\$ 102.60	July 2	-10%
Maximum	\$ 126.88	December 22	12%
Ending	\$ 126.25	December 31	11%

Finding a Suitable Substitute is Important

Example: Period Ending February 28, 2014

<u>Fund</u>	<u>Ticker</u>	<u>1-Year</u>	<u>3-Year</u>	<u>5-Year</u>
iShares Core S&P Mid Cap	IJH	26.7%	14.1%	26.7%
iShares Russell Mid Cap	IWR	29.0%	14.9%	27.6%
Difference		<u>-2.3%</u>	<u>-0.9%</u>	<u>-0.9%</u>

- Tax loss harvesting is merely deferring gains, not eliminating them.
- The benefit is sometimes overstated
- You risk the substitute investment not performing as well
- You may not be able to swap back to original investment if there is a large gain in the new investment
- Need to use common sense for implementing tax swaps



Investment
Insights

Asset Location

Investor's Funds

Fund Name	Ticker	5 Year Pre-Tax Return	5 Year After-Tax Return	Tax Cost	Desired Household Allocation for \$1 Million
Vanguard 500 Index	VFIAX	5.83%	5.45%	0.38%	\$250,000
Fidelity International Equity	FTIEX	0.15%	-0.71%	0.86%	\$250,000
Vanguard REIT Index	VGSLX	7.28%	5.72%	1.56%	\$250,000
PIMCO Commodity Real Return	PCRIX	-3.59%	-8.66%	5.07%	\$250,000
					<u>\$1,000,000</u>

Note: Annualized returns for period ending March 31, 2013

Portfolio #1

Fund Name	Ticker	Tax Cost	Taxable Brokerage Allocation	Tax Deferred IRA Allocation	Average Annual Tax Costs
Vanguard 500 Index	VFIAX	0.38%	\$125,000	\$125,000	\$475
Fidelity International Equity	FTIEX	0.86%	\$125,000	\$125,000	\$1,075
Vanguard REIT Index	VGSLX	1.56%	\$125,000	\$125,000	\$1,950
PIMCO Commodity Real Return	PCRIX	5.07%	\$125,000	\$125,000	\$6,338
			<u>\$500,000</u>	<u>\$500,000</u>	\$9,838

Note: Annualized returns for period ending March 31, 2013

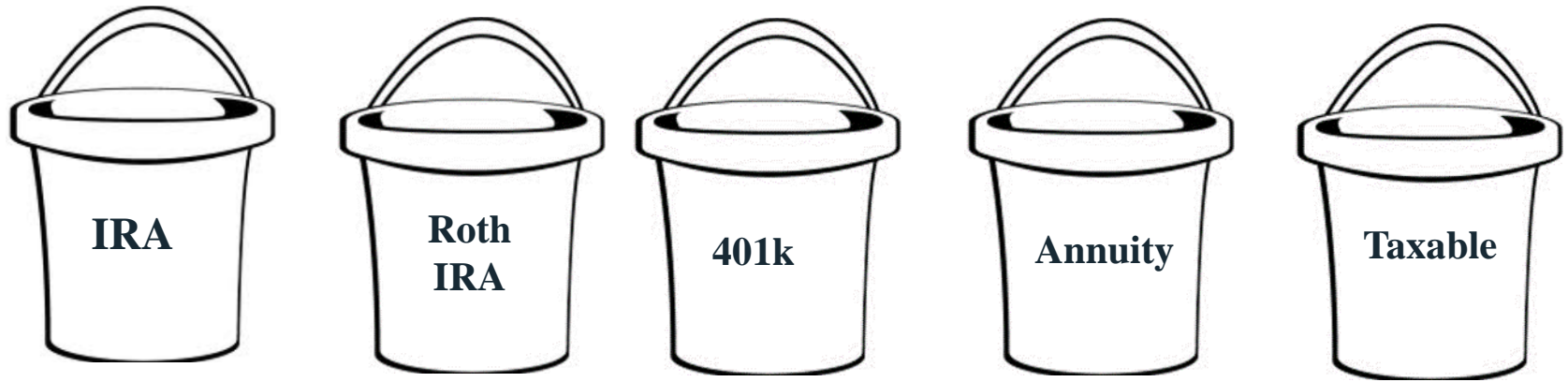
Portfolio #2

Fund Name	Ticker	Tax Cost	Taxable Brokerage Allocation	Tax Deferred IRA Allocation	Average Annual Tax Costs
Vanguard 500 Index	VFIAX	0.38%	\$250,000		\$950
Fidelity International Equity	FTIEX	0.86%	\$250,000		\$2,150
Vanguard REIT Index	VGSLX	1.56%		\$250,000	\$0
PIMCO Commodity Real Return	PCRIX	5.07%		\$250,000	\$0
			\$500,000	\$500,000	\$3,100

Note: Annualized returns for period ending March 31, 2013



Which Bucket to Place Assets??



Taxes savings are important.....but so is the growth rate

Balancing Taxes & Growth

More Tax
Efficient



Less Tax
Efficient

Municipal Bonds

U.S. Equities

Foreign Equities

Cash

Taxable Bonds

Non-Traditional Bonds

REITs

Commodities

Trading Funds/Strategies

Year End Distributions

Hypothetical Mutual Fund

Investor	Dollar Investment	Purchase Price	Purchased Shares	Year End Price	Ending Market Value	Profit	Capital Gains Distribution	43.4% Maximum ST Tax	After-Tax Profit
1	10,000	10.00	1,000	11.05	11,050	1,050	596	259	791
2	10,000	10.10	990	11.05	10,941	941	590	256	684
3	10,000	10.20	980	11.05	10,832	832	585	254	579
4	10,000	10.30	971	11.05	10,725	725	579	251	474
5	10,000	10.41	961	11.05	10,619	619	573	249	370
6	10,000	10.51	951	11.05	10,514	514	567	246	267
7	10,000	10.62	942	11.05	10,410	410	562	244	166
8	10,000	10.72	933	11.05	10,307	307	556	241	65
9	10,000	10.83	923	11.05	10,204	204	551	239	(35)
10	10,000	10.94	914	11.05	10,103	103	545	237	(133)
TOTAL	100,000		9,566		105,705	5,705	5,705		



Fund	Ticker	% of NAV
Vanguard REIT Index	VGSLX	1.54%
Fidelity Magellan	FGMAX	6.44%
PIMCO Stock Plus Long Duration	PTLDX	25.28%
Black Rock Retirement Growth	MKLHX	55.10%

Note:

Distributions based on fund literature, made on or around December of 2013

Black Rock Retirement Growth K



							Search Finance	Search Web	
Dec 18, 2013	3.87	3.87	3.87	3.87	0	3.87			
Dec 17, 2013	3.81	3.81	3.81	3.81	0	3.81			
Dec 16, 2013	3.82	3.82	3.82	3.82	0	3.82			
Dec 13, 2013	3.80	3.80	3.80	3.80	0	3.80			
Dec 13, 2013	4.656 Dividend								
Dec 12, 2013	8.45	8.45	8.45	8.45	0	3.79			
Dec 11, 2013	8.47	8.47	8.47	8.47	0	3.80			

- After the dividend payment, the investor is no further ahead
- However, they have now incurred a taxable event

Investment
Insights

Estate Allocation

- Uniform Principal and Income Act (UPAIA) provides “default” language:

Capital gains are generally allocated to principal, while interest and dividends are treated as income.

- However, the UPAIA can be overridden by language within the trust, which can minimize the impact of tax by giving trustees flexibility:

“Our Trustee shall determine how all Trustee fees, disbursements, receipts, and wasting assets will be credited, and apportioned between principal and income in a fair, equitable, and practical manner. Our Trustee may allocate capital gain to income rather than principal.”

- Why is this important?

Trust reach maximum rate for income over \$12,150.

- Flexible Bypass Trust
- Power of appointment for appreciated securities
- Appreciation of more than, say 20%
- This will allow shifting of assets to holder's estate
- Benefit = Step Up in Basis

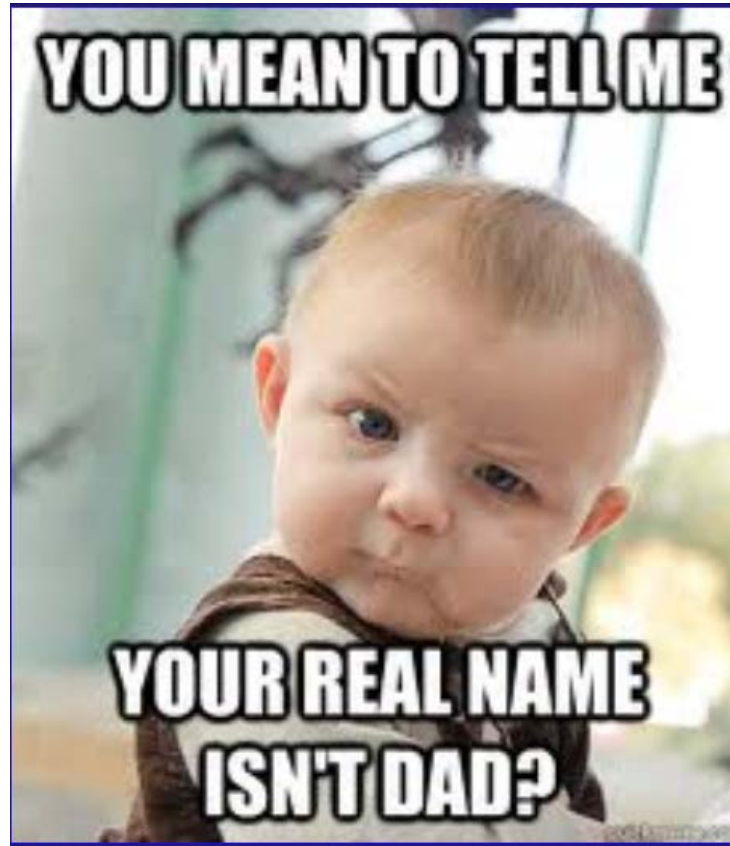
Consultant's Tax Alpha

<u>Performance Differential</u>	<u>Alpha</u>
Tax Cost	0.5% to 1.6%
Tax Loss Harvesting	0.2% to 1.6%
	<u>0.7% to 3.2%</u>

Source:

Douglas Rogers, "Tax Aware Investment Management"

Bob Veres, "Measuring Your Professional Alpha"



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