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FINANCIAL

Financial Planning

Here is a good article on asset location. Which investments should be held in tax-deferred accounts versus taxable accounts? Most investors have both. Although not mentioned in this article, there are other tax-deferred accounts with investment discretion in addition to 401k plans, including: **Nonqualified Deferred Compensation Plans**, IRAs, Variable Life Insurance and annuities among others. Many investors asset allocate for each account separately, but this article discusses advantages to asset allocating across all accounts based on tax efficiency of each investment.

October 29, 2015 By: Donald Jay Korn

Where to Place Client Assets Based on Tax Considerations

The importance of asset allocation is well accepted, but asset location also can play a vital role.

If clients have substantial holdings in both tax-deferred retirement plans and regular taxable accounts, which assets should go where?

"Clients can only spend their after-tax returns," says David Upin, a financial advisor with the Upin Sieben Group of RBC Wealth Management in Minneapolis. "So investors should not shrug off this often critical decision of placing the right asset in the right account."

TAXABLE ACCOUNTS

"We look at whether tax-free municipal bonds make sense within each client's fixed-income allocation," says Jeffrey Bell, a certified financial advisor with Edward Jones in Bakersfield, Calif. "If so, we do as much as we can in taxable accounts."

Bell also places non-dividend-paying stocks in taxable accounts. If stocks don't pay dividends, there will be no tax bill each year. Sales of such stocks in a taxable account will produce either a low-taxed capital gain, assuming a holding period of more than one year, or a capital loss that provides tax benefits.

"We have much longer time horizons for holdings in taxable accounts," Upin says.

"Broad-market, tax-efficient, equity [exchange-traded funds] are an excellent choice for long-term investments," he says. "Efficiently managed ETFs will not surprise investors with unexpected capital gain distributions like those from many mutual funds."

In addition, there may be estate planning benefits of using such equity ETFs in taxable accounts, says Dave Sieben, Upin's fellow advisor and partner.

"Equities have provided more deferred capital appreciation than bonds over the long term, so they may get a step-up in cost basis for heirs," he says.

Conversely, if appreciated equities are left to retirement plan beneficiaries that appreciation may be heavily taxed upon withdrawal.

TAX-DEFERRED ACCOUNTS

Nevertheless, advisors also find reasons for putting some equities in individual retirement accounts, 401(k)s and so on.

"Investing retirement plan assets in growth or aggressive growth not only saves current income and capital gains taxes but also helps clients focus on the long-term nature of equity investing," says Charles L. Nemes, senior vice president of investments at Nemes Rush Private Wealth Management of Raymond James in Novi, Mich. "That may take their mind off the short-term gyrations in the markets."

Maria Pisa, a financial advisor with Edward Jones in Calabasas, Calif., favors holding dividend-paying common stocks as well as funds holding such stocks in tax-deferred accounts, to defer the tax on those dividends.

"In addition, bonds [except municipals], preferred stocks and real estate investment trusts should go into those accounts," she says.

As Sieben says, "purchasing taxable bonds in taxable accounts can take a big bite out of after-tax returns, especially for high-earner clients," so yield-oriented assets may fare better in tax-deferred territory.

Donald Jay Korn is a New York-based financial writer who contributes to On Wall Street and Financial Planning.

This story is part of a 30-day series on tax planning strategies.

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