



Welcome to *Trust Connection*, our monthly newsletter highlighting Trust news and information. Each month we will feature timely articles of interest.

About Us

At Halliday Private Trust, it is our mission to assist our clients in the process of providing solutions, specifically through a wide range of financial advice.

Since 1982, we have utilized a full spectrum of financial services to help our clients navigate every major hurdle in their financial lives. Because we are an independent financial services firm, we utilize an open architecture approach to locating the most suitable investment options for our clients.

Our role is to help clients make smart decisions about their money. We understand that each client has unique needs and requires personalized solutions based on their goals, objectives and concerns.

The Importance of Asset Location

As you build investment portfolios for your clients, it is imperative to consider your strategy for asset allocation and how that squares with your client's risk tolerance. But in addition to asset allocation, asset location is also an important factor. Asset location, as distinguished from asset allocation, is a separate consideration in the investment strategy that helps to minimize the client's tax burden. Below we will discuss what asset location means and the different considerations for the respective location of assets.

Asset Location Defined

Asset location refers to where investment assets are strategically kept. The general possible locations of assets include tax-advantaged accounts, tax-free accounts, and taxable accounts. The overall strategic goal is to maximize after-tax returns.

Asset location is not the same as asset allocation, which deals more with what types of investments are made in a portfolio. For example, if 60% of a portfolio is invested in stocks, 30% invested in bonds and 10% invested in cash, that is asset allocation at work. Asset allocation is about balancing risk while still investing in a way that is designed to help clients achieve their investment goals for the short and long term.

When talking about asset location, the focus may be about how much in pre-tax dollars to contribute to an employer's 401(k) or what amount of after-tax dollars should be added to a taxable brokerage account. In other words, the focus is on where to invest with an eye toward the tax implications rather than how to invest to maximize return and minimize risk.

Tax-Advantaged vs. Taxable Accounts

To fully understand asset location and the various factors at play, it is important to know the difference between various investment account types.

Generally, there are three options for investing and saving:

- Tax-deferred accounts
- Tax-free accounts
- Taxable accounts

Tax-deferred accounts are ones that allow individuals to invest money without paying taxes on growth right away. Those accounts include traditional 401(k) plans, solo 401(k)s, traditional IRAs, SEP and SIMPLE IRAs (which follow traditional IRA tax rules for withdrawals), and 403(b) plans. With each of these

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accounts, regular income tax is paid on qualified withdrawals. Early withdrawal penalties can apply for taking money from a tax-deferred account before age 59 and 1/2.

Tax-free accounts allow individuals to save using after-tax dollars. That means that technically, the individual does not escape taxation entirely since they are contributing money on which they have already paid taxes. But when the individual makes qualified withdrawals, no additional income tax will be paid. Examples of tax-free accounts include Roth IRAs, Roth 401(k)s and Roth 403(b) plans.

Taxable accounts offer no tax breaks in the form of a deduction for contributions, which one could get with a 401(k) or a traditional IRA. And there is no avoidance of paying taxes when money is withdrawn, as is the case with a withdrawal from a Roth. Instead, taxable accounts require the payment of capital gains tax on the earnings from the investments when they are sold.

Capital gains can be applied using a short-term or long-term rate, depending on how long the assets have been held. Between the two, the long-term capital gains tax rate is more favorable. But to take advantage of it, investments must be held for at least 1 year before they are sold.

Assets can be invested in both tax-advantaged and taxable accounts at the same time to optimize the portfolio's impact on a particular individual's tax situation and to carry out the particular asset location strategy. It bears noting that an individual may not be able to have all of these accounts at one time. For example, maximum contributions to a traditional IRA and, simultaneously, a Roth IRA, cannot be made for the same tax year under IRS rules.

Why Asset Location Matters

Asset location is important for several reasons. First, it is an important part of creating a diversified portfolio. Diversification is a way to manage risk by spreading investment dollars across different assets. Asset location plays into the diversification strategy when assets are strategically placed in tax-advantaged and taxable accounts.

As an example, say an investor is concerned about having to draw down his retirement accounts early because a recession could reduce his retiree income. Having money in a taxable account, such as a brokerage account or even a taxable money market savings account, gives the retiree other options for getting the needed cash without having to drain his 401(k) or IRA.

Asset location is also important from a tax perspective. Some investments are naturally more tax-efficient than others. Exchange-traded funds (ETFs), for example, tend to have a lower holdings turnover ratio compared to other types of funds.

Keeping tax-efficient investments in a taxable brokerage account could make more sense for limiting an investor's tax liability. At the same time, investors could funnel less tax-efficient investments into a tax-advantaged 401(k), IRA or even a Health Savings Account if they have access to one of those through a high deductible health plan.

Minimizing tax liability is important when an individual is ready to start drawing down assets in retirement. The less the individual can pay in taxes on retirement income, the more of that income can be retained to cover living expenses in later years. That is especially important if the individual anticipates higher health care costs or the need for long-term care, and if the individual does not have any, or adequate, long-term care insurance.

How to Create a Tax-Efficient Investment Strategy

Making investments tax efficient, and optimizing tax strategies through asset location, starts with knowing what accounts to invest in and what an individual's goals are. If an individual has a 401(k) at work, for example, it might make sense for that individual to maximize his or her annual

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Call us today at (800) 786-1598 to learn more about working with Halliday Private Trust.

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contributions as much as possible using less tax-efficient mutual funds first. The next step may be to focus on IRA contributions, rounding things out with ETFs or low-cost index funds in a taxable brokerage account.

One thing to keep in mind is that asset location strategy is not necessarily a set-it-and-forget-it strategy. As an investor's income changes and the investor gets closer to retirement, it may be necessary to shift both the asset allocation and the asset location to keep the portfolio aligned with tax minimization goals.

It is also important to consider how things like tax-loss harvesting can help better manage the investments in taxable accounts. Tax-loss harvesting involves selling off stocks at a loss to help offset capital gains. This should fit into the overall tax mitigation strategy.

The Bottom Line

Getting asset location right is just as important as managing asset allocation. Over time, it can make a significant difference in how much tax is paid on investments and how much of the investment returns an investor can keep. As always, it makes sense to periodically analyze investment portfolios, with an eye toward the overall tax minimization strategy, to ensure that assets are being invested in the right locations.

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