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Tax & Business Alert

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TAXABLE VS. TAX-ADVANTAGED: WHERE TO HOLD INVESTMENTS

When investing for retirement or other long-term goals, people usually prefer tax-advantaged accounts, such as IRAs, 401(k)s or 403(b)s. Certain assets are well suited to these accounts, but it may make more sense to hold other investments in traditional taxable accounts.

KNOW THE RULES

Some investments, such as fast-growing stocks, can generate substantial capital gains, which may occur when you sell a security for more than you paid for it.

If you've owned that position for over a year, you face long-term gains, taxed at a maximum rate of 20%. In contrast, short-term gains, assessed on holding periods of a year or less, are taxed at your ordinary-income tax rate — maxing out at 37%. (Note: These rates don't account for the possibility of the 3.8% net investment income tax.)

CHOOSE TAX EFFICIENCY

Generally, the more tax efficient an investment, the more benefit you'll get from owning it in a taxable account. Conversely, investments that lack tax efficiency normally are best suited to tax-advantaged vehicles.

Consider municipal bonds ("munis"), either held individually or through mutual funds. Munis are attractive to tax-sensitive investors because their income is exempt from federal income taxes and sometimes state and local income taxes. Because you don't get a double

benefit when you own an already tax-advantaged security in a tax-advantaged account, holding munis in your 401(k) or IRA would result in a lost opportunity.

Similarly, tax-efficient investments such as passively managed index mutual funds or exchange-traded funds, or long-term stock holdings, are generally appropriate for taxable accounts. These securities are more likely to generate long-term capital gains, which have more favorable tax treatment. Securities that generate more of their total return via capital appreciation or that pay qualified dividends are also better taxable account options.

TAKE ADVANTAGE OF INCOME

What investments work best for tax-advantaged accounts? Taxable investments that tend to produce



DOING DUE DILIGENCE ON DIVIDENDS

If you own a lot of income-generating investments, you'll need to pay attention to the tax rules for dividends, which belong to one of two categories:

1. **Qualified.** These dividends are paid by U.S. corporations or qualified foreign corporations. Qualified dividends are, like long-term gains, subject to a maximum tax rate of 20%, though many people are eligible for a 15% rate. (Note: These rates don't account for the possibility of the 3.8% net investment income tax.)
2. **Nonqualified.** These dividends — which include most distributions from real estate investment trusts and master limited partnerships — receive a less favorable tax treatment. Like short-term gains, nonqualified dividends are taxed at your ordinary-income tax rate.

much of their return in income. This category includes corporate bonds, especially high-yield bonds, as well as real estate investment trusts (REITs), which are required to pass through most of their earnings as shareholder income. Most REIT dividends are nonqualified and therefore taxed at your ordinary-income rate.

Another tax-advantaged-appropriate investment may be an actively managed mutual fund. Funds with significant turnover — meaning their portfolio managers are

actively buying and selling securities — have increased potential to generate short-term gains that ultimately get passed through to you. Because short-term gains are taxed at a higher rate than long-term gains, these funds would be less desirable in a taxable account.

GET SPECIFIC ADVICE

The above concepts are only general suggestions. Please contact our firm for specific advice on what may be best for you. ■

IS NOW THE TIME FOR SOME LIFE INSURANCE?

Many people reach a point in life when buying some life insurance is highly advisable. Once you determine that you need it, the next step is calculating how much you should get and what kind.

CAREFUL CALCULATIONS

If the coverage is to replace income and support your family, this starts with tallying the costs that would need to be covered, such as housing and transportation, child care, and education — and for how long. For many families, this will be only until the youngest children are on their own.

Next, identify income available to your family from Social Security, investments, retirement savings and any other sources. Insurance can help bridge any gaps between the expenses to be covered and the income available.



If you're purchasing life insurance for another reason, the purpose will dictate how much you need:

Funeral costs. An average funeral bill can top \$7,000. Gravesite costs typically add thousands more to this number.

Mortgage payoff. You may need coverage equal to the amount of your outstanding mortgage balance.

Estate planning. If the goal is to pay estate taxes, you'll need to estimate your estate tax liability. If it's to equalize inheritances, you'll need to estimate the value of business interests going to each child active in your business and purchase enough coverage to provide equal inheritances to the inactive children.

TERM VS. PERMANENT

The next question is what type of policy to purchase. Life insurance policies generally fall into two broad categories: term or permanent.

Term insurance is for a specific period. If you die during the policy's term, it pays out to the beneficiaries you've named. If you don't die during the term, it doesn't pay out. It's typically much less expensive than permanent life insurance, at least if purchased while you're relatively young and healthy.

Permanent life insurance policies last until you die, so long as you've paid the premiums. Most permanent policies build up a cash value that you may be able to borrow against. Over time, the cash value also may reduce the premiums.

Because the premiums are typically higher for permanent insurance, you need to consider whether the extra cost is worth the benefits. It might not be if, for example, you may not require much life insurance after your children are grown.

But permanent life insurance may make sense if you're concerned that you could become uninsurable, if you're providing for special-needs children who will never be self-sufficient, or if the coverage is to pay estate taxes or equalize inheritances.

SOME COMFORT

No one likes to think about leaving loved ones behind. But you'll no doubt find some comfort in having a life insurance policy that helps cover your family's financial needs and plays an important role in your estate plan. Let us help you work out the details. ■

GETTING CAUGHT UP WITH THE LATEST CATCH-UP CONTRIBUTIONS

One could say that there are only two key milestones in retirement planning: the day you begin participating in a retirement savings account and the day you begin drawing money from it. But, of course, there are others as well.

One is the day you turn 50 years old. Why? Because those age 50 or older on December 31 of any given year can start making "catch-up" contributions to their employer-sponsored retirement plans by that date. These are additional contributions to certain retirement accounts beyond the regular annual limits.

Maybe you haven't yet saved as much for retirement as you'd like to. Or perhaps you'd just like to make the most of tax-advantaged savings opportunities. Whatever the case may be, let's get caught up with the latest catch-up contribution amounts.

401(k)s AND SIMPLEs

Under 2018 401(k) limits, if you're age 50 or older, after you've reached the \$18,500 maximum limit for all employees, you can contribute an extra \$6,000, for a total of \$24,500. If your employer offers a Savings Incentive Match Plan for Employees (SIMPLE) instead, your regular contribution maxes out at \$12,500 in 2018. If you're 50 or older, you're allowed to contribute an additional \$3,000 — or \$15,500 in total for the year.

But, check with your employer because, while most 401(k) plans and SIMPLEs offer catch-up contributions, not all do.

SELF-EMPLOYED PLANS

If you're self-employed, retirement plans such as an individual 401(k) — or solo 401(k) — also allow catch-up contributions. A solo 401(k) is a plan for those



with no other employees. You can defer 100% of your self-employment income or compensation, up to the regular yearly deferral limit of \$18,500, plus a \$6,000 catch-up contribution in 2018. But that's just the employee salary deferral portion of the contribution.

You can also make an "employer" contribution of up to 20% of self-employment income or 25% of compensation. The total combined employee-employer contribution is limited to \$55,000, plus the \$6,000 catch-up contribution.

IRAs, TOO

Catch-up contributions to non-Roth accounts not only can enlarge your retirement nest egg, but also can reduce your 2018 tax liability. And keep in mind that catch-up contributions are available for IRAs, too, but the deadline for 2018 contributions is April 15, 2019. If you have questions about catch-up contributions or other retirement saving strategies, please contact us. ■

YEAR-END TAX STRATEGIES FOR ACCRUAL-BASIS BUSINESSES

The last month or so of the year offers accrual-basis taxpayers an opportunity to make some timely moves that might enable them to save money on their 2018 tax bills. The key to saving tax as an accrual-basis taxpayer is to properly record and recognize expenses that were incurred this year but won't be paid until 2019. Doing so will enable you to deduct those expenses on your 2018 federal tax return.

Common examples of such expenses include commissions, salaries and wages; payroll taxes; advertising; and interest. Also look into expenses such as utilities, insurance and property taxes. You can also accelerate deductions into 2018 without paying for the expenses in 2018 by charging them on a credit card. (This works for cash-basis taxpayers, too.)

In addition, review all prepaid expense accounts and write off any items that have been used up before the end of the year. If you prepay insurance for a period beginning in 2018, you can expense the entire amount



this year rather than spreading it between 2018 and 2019, as long as a proper method election is made. This is treated as a tax expense and thus won't affect your internal financials.

There are many other strategies to explore. Review your outstanding receivables and write off any receivables you can establish as uncollectible. Pay interest on all shareholder loans to the company. Update your corporate record book to record decisions and be better prepared for an audit. Interested? We can provide further details on these and other year-end tax tips for accrual-basis businesses. ■