

ENJOYING THE RIDE

DON'T WAIT UNTIL APRIL TO CREATE YOUR TAX STRATEGY



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When people think of April, many think of filing their taxes; but tax strategies should be a continuous year-

long process. There is a difference between tax preparation and tax planning, the latter being an integral part of having a strategic financial plan.

One of the more symbiotic relationships in financial planning is tax-efficient investing. Just like clients are encouraged to diversify their investments, they should also consider diversifying how their portfolio assets are taxed and seek tax efficiency throughout. One should consider a three-prong process:

Pre tax, tax-deferred, taxable: These are assets, placed mainly through retirement plans at the workplace, allowing investment directly from your paycheck before taxes. These assets have the potential to grow tax-deferred until they are distributed years later. Many of these plans also allow for a company match. The most common programs are qualified retirement plans (QRPs) which provide defined contribution, such as 401ks (for-profit companies), 403(b)s (non-profit organizations), governmental 457s (state/local government employees), and Thrift Savings Plans (federal employees). However, some employers may offer a defined benefit retirement plan such as a pension.

For the self-employed, depending on whether you have employees, you can utilize SEP IRAs, SIMPLEs, Solo 401ks, and Defined Benefit plans. If your Modified Adjusted Gross Income allows, you can also adopt this tax-deferred savings strategy through a Traditional IRA, subject to annual limits. This first strategy may allow the taxpayer to reduce their tax liability during the accumulation period but pay taxes upon distribution once they have reached retirement age, hopefully at a lower tax rate.

Post tax, tax-deferred, tax-free: These assets work the opposite as option one. Here, you've

already paid taxes on money being contributed to the account. This money then has the potential to grow, tax deferred, until retirement age, at which point a qualified distribution would be tax free, and they're placed into investments that grow tax-deferred and can eventually be withdrawn tax-free. The most common vehicles in this space are Roth IRAs, designated Roth QRP accounts, 529 Plans, and Coverdell Education Savings accounts. Here are the two main Roth IRA strategies:

a. Contributions— the same contribution limits apply to Roth IRAs as Traditional IRAs. The total contribution to all of your Traditional and Roth IRAs cannot be more than the annual maximum for your age or 100% of earned income, whichever is less. Investment earnings are distributed tax-free in retirement, if a five-year waiting period has been met and you are at least age 59 and a half, or as a result of your disability, or using the first-time homebuyer exception, or taken by your beneficiaries due to your death. Many retirement plans have designated Roth accounts, contribution limits and distribution rules are different than for a Roth IRA.

b. Conversions — An excellent way to benefit from tax-advantaged growth potential and possible tax-free distributions may be to convert your Traditional IRA or QRP eligible rollover distribution to a Roth IRA.⁴ It is important to remember that you must have a triggering event, such as separation of service, to be eligible to make distributions from your QRP. At the time of conversion, you will pay the appropriate taxes due, but the benefits of tax-free income in retirement may justify the conversion. One benefit is that any earnings would be distributed tax-free, if the Roth IRA has been open for longer than five years and you are at least age 59 and a half, or you are disabled, or you are using the first-time homebuyer exception.

Taxable but tax-efficient: These assets are invested as post-tax dollars, but are tax efficient. Typical examples of this are tax-free municipal bonds that can yield tax free income, and aggressive growth stocks, that allow for very little 1099B, 1099DIV, or 1099INT taxation and are usually subject to lower capital gains tax rates. Annuities also allow for tax-deferred growth potential and come in a variety of types,

including fixed and variable annuities that utilize growth-oriented, professionally managed, and diversified separate accounts. Finally, for those interested in actively investing in real estate, you can utilize 1031 exchanges for tax-deferral of physical rental real estate.

Again, there's a clear difference between tax preparation and strategic tax planning, whereas the former takes place once per year, and the latter should be considered in all aspects of your strategic financial plan and revisited continuously. Working with a financial advisor and incorporating different tax strategies across your financial plan allows you more potential in reaching your financial goals and limiting tax liability and allows you to enjoy the ride.

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There are many types of distribution options available to an investor when taking money from an annuity. These options include a lump sum, partial withdrawals, systematic withdrawals and annuitization. All withdrawals of earnings will be fully taxable and if taken before the age of 59 1/2 may be subject to a 10% IRS penalty. For variable contracts, please see the prospectus for complete information on distribution options with annuities.

Fixed annuities may have a higher initial interest rate which is guaranteed for a limited time period only. At the end of the guarantee period, the contract may renew at a lower rate.

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