

**TAX ALPHA® CHECKLIST**  
**BEST INCOME TAX STRATEGIES FOR FINANCIAL PROFESSIONALS**  
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With the introduction of the 3.8% net investment income tax (NIIT), the 20% capital gains rate, the 39.6% income tax rate, and the PEP and Pease limitations, America has shifted from a two dimensional tax system to a five dimensional system. Virtually every financial decision now needs to be analyzed through the lens of the regular income tax, the AMT, the NIIT, the new additional brackets for high income taxpayers (the “supertax”), and the PEP and Pease limitations. The complexity of going from a two dimensional system to a five dimensional system is exponential, not linear, which requires a quantum leap in tax analysis methodology, tax strategy and tax planning software tools.

There are now seven different ordinary income tax brackets – 10%, 15%, 25%, 28%, 33%, 35%, and 39.6%, and three different capital gains tax brackets – 0%, 15%, and 20%. Furthermore, if you combine these tax brackets with the new 3.8% NIIT, there are even more possible tax brackets; i.e., high income taxpayers will be subject to a 43.4% tax rate on ordinary investment income and a 23.8% tax rate on long-term capital gains. Lastly, when taking into account the phase-out of personal exemptions (PEP) and limitations on itemized deductions (Pease) as income rises above the applicable threshold amounts, the tax rates increase even further.

The increased value created in an investment portfolio by using the tax saving strategies described below is referred to as “Tax Alpha®.” Put another way, it is your after-tax excess return (after-Tax Alpha®) minus your pre-tax excess return (pre-Tax Alpha®) based on the appropriate benchmarks. Generally, an index is used as the appropriate benchmark (e.g., the Russell 1000 for U.S large cap stocks). Research indicates that many portfolios don’t consistently beat their benchmarks on a pre-tax basis, often producing negative alpha on an after-tax basis. That is why creating Tax Alpha® is so important. If pre-tax alpha is positive, tax planning can increase the excess.

**IRA AND ROTH IRA STRATEGIES**

1. Roth IRA conversions to “fill-up brackets”
2. Roth IRA conversions by asset class with recharacterization
3. Roth IRA conversions when basis exists
4. Roth 401(k) bracket analysis
5. Roth IRA fees paid from “outside” broker accounts
6. Asset location with Roth IRAs and Traditional IRAs
7. Taking IRA and Roth IRA distributions in December rather than January
8. Making IRA and Roth IRA contributions in January rather than December
9. IRA Distributions to “fill-up brackets”
10. Carefully planning for pre-age 59 ½ distributions

### **CAPITAL GAIN/LOSS STRATEGIES**

11. Harvest capital gains to the extent of the 15% regular tax bracket
12. Harvest capital losses to offset capital gains at the 15%, 20%, and 23.8% capital gain tax brackets
13. Harvest capital gains to the extent under the 3.8% net investment income tax thresholds
14. Engage in capital gain and loss planning on a separate lot basis
15. Consider Charitable Remainder Trusts to diversify on a tax efficient basis
16. Consider “low-turnover” strategies to defer capital gain income

### **BOND INCOME STRATEGIES**

17. Consider tax deferred annuities to “Leap-Frog” over high income years
18. Consider life insurance to replace a portion of the bond portfolio
19. Consider tax-exempt, double exempt, and private activity bonds
20. Consider a higher asset allocation to low risk / low volatile high dividend yield stocks to obtain “qualified dividends rather than interest”
21. Consider an immediate annuity to defer taxable income while recovering basis

### **DIVIDEND INCOME STRATEGIES**

22. Avoid margin status for stocks with qualified dividends because “qualified dividend” status is lost
23. Consider utilizing only “qualified dividend” stocks to obtain “qualified dividends” taxed at a lower rate
24. Avoid acquiring stocks immediately prior to the payment of dividends

### **OPTION TRANSACTION STRATEGIES**

25. Consider that most protective puts results in “tolling” the holding period for stocks
26. Consider that most protective puts result in qualified dividends to be treated as ordinary dividends
27. Consider that the loss on covered calls, except for “qualified covered calls,” results in a straddle and suspension of capital losses until the underlying stock is sold

### **PENSION DISTRIBUTION STRATEGIES**

28. Consider stock distributions that take advantage of net unrealized appreciation strategies
29. Consider basis and “after-tax” amounts when analyzing distribution options
30. Carefully plan for pre-age distributions

### **STOCK OPTION STRATEGIES**

31. Consider the AMT Impact of incentive stock options
32. Balance deferral of stock option income with “one-stock” portfolio risks

### **CHARITABLE PLANNING STRATEGIES**

33. Consider gifting appreciated securities to a donor advised fund
34. Consider gifting appreciated securities directly to qualified charitable organizations
35. Consider the impact of the 50%, 30%, and 20% deduction limitations
36. Avoid contributing short-term capital gain property to charity
37. Fulfill charitable gifts with IRA assets at death

### **SPECIALIZED INVESTMENT STRATEGIES**

38. Consider oil and gas partnerships for high income sophisticated clients
39. Consider master limited partnerships for high income sophisticated clients
40. Consider that master limited partnerships for Traditional IRAs and Roth IRAs will generate unrelated business taxable income
41. Consider REITs to add cash flow to a portfolio with some tax shelter
42. Consider real estate partnerships to add cash flow with a “depreciation tax shield”

### **STRATEGIC TAX ALPHA® STRATEGIES**

43. Consider maximizing IRAs, 401(k)s, and deferred compensation
44. Utilize low-turnover strategies for taxable portfolios
45. Focus on deferral strategies for “Bond-type” investments utilizing IRAs, annuities, and life insurance
46. Consider asset allocation strategies allocating bonds to IRA and qualified plans and stock to “outside” portfolios and Roth portfolios
47. Consider bracket management strategies to smooth out income and avoid the 3.8% NIIT and the highest margin rates
48. Fully utilize the latest draw down strategies to efficiently manage tax brackets
49. Defer capital gains for older clients to obtain a step-up in basis at death
50. Hold high turnover small cap equity funds in Roth IRAs

### **TACTICAL TAX STRATEGIES**

51. Develop a 10-15 year projection to determine a permanent tax bracket before and after the required beginning date
52. Consider “IRA Relocation,” i.e., shifting assets from an IRA account to life insurance
53. Manage the taxation of social security benefits with deferral and timing strategies
54. Manage Medicare insurance premiums with deferral and timing strategies
55. Consider income generation strategies when the AMT is imposed to engage in low-tax rate Roth conversions and taxable withdrawals
56. Consider timing of state income and property taxes for AMT purposes
57. Consider timing of state income and property taxes for Net Investment Income Tax purposes
58. Consider the Substantial Sale CRT strategy

59. Consider the Retirement CRT strategy
60. Consider the Income Shifting CRT strategy
61. Consider the NING, SING, and WING trusts to avoid state income taxes
62. Consider shifting capital gain property to adult children prior to sale
63. Consider 529 plans for college savings
64. Consider Educational IRAs for college savings
65. Consider low-turnover index funds and managing AGI for college savings and to obtain college tax credits
66. Consider that the kiddie tax only applies to the regular tax and AMT and not to the NIIT
67. Consider the defined benefit pension plans for selected clients
68. Consider private placement partnerships that generate passive income for clients with passive loss carry forwards
69. Consider LLCs or limited partnerships to shift income to younger family members
70. Consider IRC §42 low income housing partnerships when the client can utilize the low income housing credits and when the return on investment matches the risk

### **TRUSTS AND ESTATES**

71. Consider harvesting losses on securities in a post-mortem setting following a step-up in basis
72. Consider life insurance to avoid the 39.6%+3.8% combined tax
73. Consider annuities to avoid the 39.6%+3.8% combined tax
74. Consider all available options for post-mortem IRA planning, including spousal rollovers and life expectancy distributions
75. Consider, with the client's other advisors, trust and estate distributions to shift income into the lower tax brackets

### **CONCLUSION**

Taxes are the most important drag on investment return--greater than inflation, transaction costs or management fees. Studies performed ten to fifteen years ago showed that taxes reduced returns by an average of one to three percentage points. Recent tax increases should increase these percentages significantly, making it more important than ever to manage tax drag and create positive Tax Alpha<sup>®</sup> for clients. Given the growing realization of the power of Tax Alpha<sup>®</sup>, more and more investors will demand it from their advisors.

With the focus of investment strategies changing rapidly, in order for financial advisors to add value for their clients, they will need to add Tax Alpha<sup>®</sup>; or, in other words, alpha by virtue of reducing the effective tax rate on investment returns. The heart of Tax Alpha<sup>®</sup> is understanding and utilizing the statutory tax shelters provided within the Internal Revenue Code.

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