

Look for Ways to Cut Investment Taxes

Like millions of your fellow citizens, you may be filing your taxes this week. If you think things might have turned out differently had you paid less in investment-related taxes, you can take steps now to help ensure a different outcome in 2011.

Here are some “tax-smart” strategies to consider:

- *Invest in tax-free municipal bonds.*

If you’re in an upper income bracket, you might benefit from owning tax-free municipal bonds. The interest payments from “munis” are typically exempt from federal income taxes and may also be exempt from state and local taxes, depending on where you live. (However, the interest from some types of munis may be subject to the alternative minimum tax, or AMT.)

- *“Max out” on your Roth IRA.* If you qualify for a Roth IRA, try to fully fund it every year. Your earnings grow tax free, provided you’ve had your account at least five years and you don’t take withdrawals until you’re at least 59½. And as of 2010, everyone can qualify to convert a traditional IRA to a Roth IRA. (Under previous rules, you could convert only if your modified adjusted gross income, or MAGI, was \$100,000 or less.) If you convert in 2010, your conversion amount will be split and reported as income for tax years 2011 and 2012, unless you elect to report the entire conversion on your 2010 taxes.

- *Distribute assets between taxable and retirement accounts.* You’ll want to review all your investments to determine if they’re working together to help you achieve your goals. But in considering ways to help control investment taxes, you may also find it useful to look at two separate categories: your tax-deferred retirement

accounts, such as a traditional IRA or 401(k), and your taxable accounts. As a general rule, you might consider putting income-producing securities, such as taxable bonds, into a tax-deferred retirement account. When you ultimately take out this money, presumably at retirement, your withdrawals will be taxed at your income tax rate, which may be lower by then. Conversely, you may want to consider adding growth-oriented securities, such as stocks, to a taxable account. As long as you hold these assets at least a year, you’ll pay the long-term capital gains rate, which is currently 15% if you’re in one of the top three tax brackets. (This rate may soon rise, however.)

- *Sell your “losers” throughout the year.* If you own investments that have lost value and that you don’t need to keep for other reasons (such as portfolio balance), consider selling them throughout the year. Your losses can offset any capital gains you might have achieved; if you don’t have any gains, the losses can offset up to \$3,000 of your regular income. Plus, any losses you don’t use in a given year can be carried forward indefinitely for use against future capital gains.

Before embarking on any of these strategies, consult with your tax advisor. Some “tax-smart” moves may not be appropriate for your situation. But if you’re concerned about the impact of investment taxes, it can pay to explore all your options.

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