The Importance of Tax Planning On Investment Returns

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A CPA friend was recently telling me about a client who had to pay substantially more income taxes because his investment advisor failed to consider applicable long-term capital gain tax rules.

This client had an investment portfolio that had appreciated in value during the year and required re-balancing. When making the recommendation to re-balance the investment advisor indiscriminately executed trades based on simple targets without giving consideration to holding periods. One of the mutual funds sold had been purchased about 350 days earlier, which meant the gain on sale was classified as a short term capital gain and taxed at the client's marginal income tax rate of 35% – which happens to be the highest individual income tax rate possible.

Had the investment advisor merely waited two more weeks to re-balance - or at least waited two weeks to sell this one mutual fund in the re-balancing process – the client's holding period would have been greater than one year and the gain would have been taxed at a much lower 15% long-term capital gains rate – a difference of 20% in Federal income taxes paid.

This gaffe by the investment advisor cost the client dearly in additional income taxes. What the markets had rewarded the client for taking risks, the investment advisor took away through inadequate tax planning. The United States Treasury was more than happy to receive the benefit of this error. This was an easily preventable cost that the investment advisor failed to recognize and avoid.

This situation underscores the importance of making sure your investment advisor understands and incorporates income tax rules and regulations into their investment advice. If your investment advisor does not have tax training and experience you run additional risk of sharing more of your market returns with the government than you have to. If you are okay with that, fine. Most people are not okay with that. If you are like most people then you will need a process to incorporate tax planning into your investment decisions.

At Pile Wealth Management, we have extensive understanding and knowledge about tax laws and their impact on investment selection, gains and losses. After all, many of our advisors are also CPA's; and we are backed by the resources of a large local CPA firm that has been in business for 73 years and prepares more than 700 individual and business income tax returns every year. We can also help our investment clients navigate charitable giving, inheritance, generational gifting and estate tax matters. Our experience means that our investment clients receive advice that is highly tax efficient resulting in lower tax consequences. Greater tax efficiency means greater after tax returns that stay in our clients' accounts.

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