Dwayne M. Dills, CPA, PC
Financial Advisor and Certified Public Accountant

18-D Regent Park Blvd. • Asheville, NC 28806
Phone: 828-398-0258 • Fax: 828-225-3900

Financial Briefs

JULY/AUGUST 2018

Tax Planning Throughout Life

Most people do not plan their taxes throughout the year or into the future. They file their taxes and then shunt the whole process aside until the next year. This is a huge mistake, often made because most people believe that tax planning is only for the ultrawealthy. In reality, anyone who earns money and files taxes can save money by planning throughout their life.

In Your 20s

The good news is that you're probably not heavily taxed yet, but the bad news is it is because you are not making very much money. Chances are this is the first time you start filing taxes on your own without being claimed as a dependent of your parents. Make sure you have all of your key financial documents organized and identity information like your birth certificate and Social Security card in a secure place. If your parents opened any accounts for you when you were younger, make sure you have all relevant paperwork now. Consider meeting with an accountant or advisor to make sure you start off on the right foot. Tips:

- Contribute to a tax-deferred retirement account, like a 401(k) plan or IRA. Take full advantage of any employer-matching contributions, even if you want to pay off student loans quickly. That free money will likely grow in your account at a higher rate of return than your low-interest loans.
- Keep track of what you pay on student loans. You can deduct interest paid on your loans when filing taxes and can sometimes qualify for an income-based repayment plan if you owe more than you make.
- Save receipts and records if you relocate for a job, since these

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Downside of Taxes Determining Investment Strategy

While you should always keep the tax consequences of investment decisions in mind, it's a mistake to let them drive those decisions. Why? Because the goals for each are fundamentally different: the goal of investing is to make money over the long run, while the goal of tax planning is to minimize paying taxes in the short run.

Ideally, these goals should complement each other to achieve the maximum long-term growth of your portfolio given your investment objectives and risk tolerance. The danger is that by trying to avoid paying taxes today, you will frustrate your efforts to make the money you need for tomorrow. A few examples of what can go wrong will illustrate the point.

Skewing Your Asset Allocation

Studies have found that the most important factor in determining an investor's long-term rate of return is asset allocation, or how your portfolio is spread out among the different classes of investments: stocks, bonds, cash, real estate, and commodities. When properly structured, your portfolio aims for a given rate of return that's been chosen to meet your long-term financial needs.

One way to decrease the absolute dollar amount of taxes paid is to minimize returns. You can accomplish that by concentrating in low-return investments, like money market funds, savings accounts, certificates of deposit, or bonds. But if your investment goals require the higher rate of return only obtained through stocks, this strategy will succeed at minimizing returns, but fail to meet investment goals.

Concentrating Investment and Credit Risk

Municipal bonds are a great way to reduce your exposure to both federal and state taxes. While a municipal bond from any state shelters interest payments from federal

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Tax Planning

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expenses can be deducted.
- Make sure you are withholding the correct amount. Getting a big refund at tax time is exciting; but by withholding too much, you let the government sit on your cash instead of making it work for you during the year.

In Your 30s

Now your finances get significantly more complicated as your savings increase along with your expenses. Tips:
- Keep saving in tax-deferred accounts, but also consider opening a tax-free account like a Roth IRA or Roth 401(k) plan, so you will have more income options in retirement.
- If you plan to get married or have children, meet with a tax or financial advisor to ensure you are making the best financial decisions for this point in your life. Consider setting up a 529 plan for your children's educations.
- Review the credits and deductions available to you, especially the ones related to child and dependent care.
- Use a flexible spending plan and reimbursement accounts for any medical bills.

In Your 40s

This is when you will probably hit your earning peak. This may bump you into a higher tax bracket, so maximizing possible deductions (like contributions to a retirement account) is more important than ever. Tips:
- Upgrade your charitable giving and keep track of any eligible gifts made. Keep all documentation so you can deduct your contributions at tax time.
- Make sure to meet with an advisor before drawing money from taxable investment accounts for large expenses (such as your child's college tuition), as there may be complicated tax ramifications. Also stay abreast of any tax credits for education: your child's or your own.

In Your 50s

Retirement is edging closer and you should now be focused on saving as much as possible. Tips:
- Max out your contributions to IRAs and 401(k) plans. Now that you've turned 50, you can contribute an extra $6,000 to your 401(k) plan and an additional $1,000 to your IRA in 2018.
- Start planning for future healthcare expenses. Open a tax-free health savings account to reduce taxable income now and provide a fund for health expenses in retirement.
- Know the tax implications of cashing out any stock options or other perks from your employer.

In Your 60s

This tax-planning decade is crucial to your retirement years. Tips:
- Plan for all taxes that may apply to you in retirement. For example, your retirement income level will determine whether you have to pay taxes on Social Security benefits.
- Consider converting a tax-deferred IRA to a Roth IRA for tax-free income in retirement (but know you will have to pay any taxes owed when converting).
- Be careful and strategic about how you make withdrawals to avoid paying higher taxes than necessary. Form a plan with your advisor to ensure you are not paying more than necessary.

Please call if you would like to discuss this in more detail.

Should You Defer Income Taxes?

Should you pay income taxes now so you can withdraw funds after retirement tax free? Or are you better off delaying income taxes until after retirement? This is the basic decision when choosing between a traditional deductible individual retirement account (IRA) or a Roth IRA or between a 401(k) plan or a Roth 401(k). With the Roth options, you are paying taxes now so you can take qualified distributions income-tax free. With the traditional IRA and 401(k) plan, you are delaying taxes until distributions are taken.

The standard advice is to consider whether your tax bracket will be higher or lower in retirement. If you are likely to be in a higher tax bracket, you'll usually benefit from the Roth options because you will be paying taxes at a lower rate now. If you're likely to be in a lower tax bracket, you may benefit more from a traditional IRA and 401(k) plan, because you'll pay taxes at a lower rate after retirement.

Most people naturally assume their tax rate will be lower in retirement since their income will typically be lower. That assumes income tax rates will stay constant over that time period, even though they are at historically low levels. No one knows how those rates will be adjusted by Congress over the years. However, many believe income tax rates have nowhere to go but up.

Thus, it may be prudent to use tax diversification for your portfolio. This strategy attempts to protect your portfolio against tax-rate fluctuations. It is a concept similar to asset allocation in which you protect your portfolio against price fluctuations. With tax diversification, you invest in a number of investment vehicles with different tax ramifications. For instance, you might invest in a Roth IRA, from which qualified distributions can be taken with no tax consequences; a 401(k) plan, saving you taxes now and charging ordinary income taxes on qualified distributions; and taxable accounts, in which capital gains taxes must be paid on sales of appreciated investments. During retirement, you can monitor your tax situation and withdraw money from the assets that make the most sense during any particular year.

Please call if you'd like to discuss this in more detail.

Downside of Taxes

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taxation, only municipal bonds issued from your resident state will lower your liability for state income taxes. For that reason, investors frequently confine their municipal bond investments to in-state issues. The problem with that is concentrating exposure to the risk that your home state could run into financial problems, jeopardizing your returns.

When it comes to municipal bond portfolios, it can pay to diversify, both away from a single issuer and single state. That way, you reduce the risk the market value of your bonds will suffer from a default or credit downgrade.

Holding on to an Investment Too Long

The higher tax rate on short-term capital gains — those realized in less than a year — than on long-term gains encourages some investors to hold on to an investment too long. Stock prices can move quickly, and holding on to a stock just because you want a more favorable tax rate can cause you to lose some or all of your profits or deepen the losses you've already suffered.

Selling an Investment Too Soon

Conversely, investors can be tempted to sell a stock prematurely in an attempt to harvest capital losses to shelter capital gains. While it might be a good idea to exit a stock position before its losses mount, you could regret it if the sold stock later returns big gains. Selling may also leave a hole in your asset allocation strategy and diminish your portfolio's level of risk-reducing diversification.

The Proper Approach to Tax-Efficient Investing

That doesn't mean taxes are a good thing or you shouldn't try to minimize the taxes your investments trigger. But there's a wrong way to go about it — and a right way, which consists of doing the following:

- Taking full advantage of tax-sheltered investment retirement accounts, like IRAs, 401(k) plans, and annuities.
- Investing in municipal bonds only when they generate a higher after-tax rate of return.
- Selling stocks based on their intrinsic ability to generate gains or losses.
- Prudently culling losing stocks from your portfolio when harvesting capital losses.

Please call if you'd like to discuss this in more detail.

What Is Tax-Loss Harvesting?

Tax-loss harvesting is choosing to sell some investments at a loss to reduce taxes on realized capital gains from other investments.

Assess Your Capital Gains

Thoroughly review your investments to determine a rough estimate of your capital gains. If you frequently buy and sell, you most likely have both short- and long-term gains and losses. Long-term capital gains are those on investments you've held longer than one year, while short-term capital gains are from those held for one year or less.

If you are a buy-and-hold mutual fund investor, your gains are more likely to be in mutual fund distributions.

Estimate Your Tax Liability

After figuring out the potential amount of your capital gains, you will want to estimate your potential taxes from realized gains based on the type of gain it is and your income.

Short-term capital gains are taxed as ordinary income, so your marginal tax rate applies to them. Long-term capital gains tax rates are much more favorable:

- A 0% long-term capital gains rate applies for joint filers with income of $0 to $77,200 and single filers with income of $0 to $38,600.
- A 15% long-term capital gains tax rate applies for joint filers with income of $77,201 to $479,000 and single filers with income of $38,601 to $425,801.
- A 20% long-term capital gains tax rate applies for joint filers with income over $479,000 and single filers with income over $425,800.

There is also a 3.8% net investment income tax for high-income taxpayers above specific income thresholds.

Harvesting Losses

Once you have an understanding of what you will owe in capital gains taxes, you can start looking for investments you may want to sell. First consider investments that no longer fit into your strategy or those that have poor prospects for growth.

Try to apply as much of your capital loss to short-term gains as possible, because they are taxed at a higher rate. The tax code states short- and long-term losses must first be used to offset gains of the same type. If you have losses of one type that exceed what you have gained, you may apply the excess to other types of capital gains.

Additionally, if you don't have any gains in a given year, the tax code allows you to apply up to $3,000 in capital losses to reduce your taxable income.

Watch out for the Wash-Sale Rule

Even though you took a loss on an investment to reduce your capital gains taxes, you may decide it is still an attractive investment because it has good potential and fits within your investment strategy. Be aware of when you buy it, because the IRS wash-sale rule will disallow your tax write-off if you buy the same security, an option to buy the security, or a substantially identical security within 30 days before or after the date you sold the security with the loss.

Business Data

Indicator	Month-end Apr-18	Month-end May-18	Month-end Jun-18	Month-end Dec-17	Month-end Jun-17
Prime rate	4.75	4.75	5.00	4.50	4.25
3-month T-bill yield	1.84	1.90	1.90	1.45	1.02
10-year T-note yield	2.88	3.07	2.91	2.46	2.16
20-year T-bond yield	2.96	3.14	2.97	2.66	2.49
Dow Jones Corp.	3.88	3.89	3.94	3.13	2.99
GDP (adj. annual rate)#	+3.20	+2.90	+2.00	+2.90	+1.20

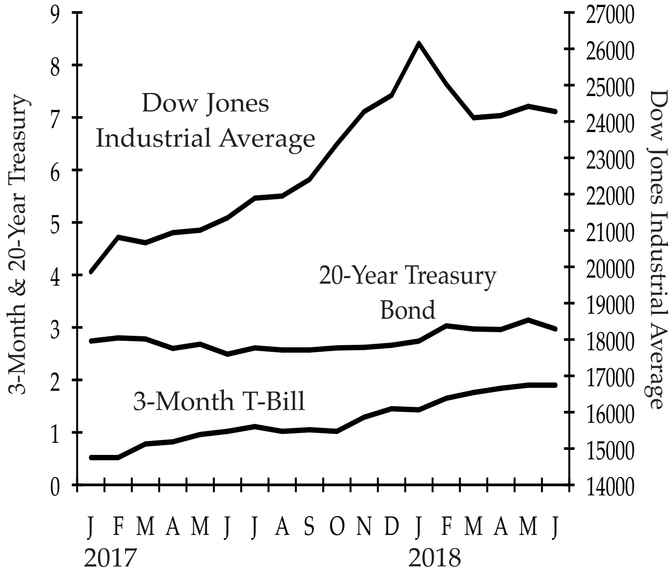
Indicator	Month-end Apr-18	Month-end May-18	Month-end Jun-18	% Change YTD	% Change 12-Mon.
Dow Jones Industrials	24163.15	24415.84	24271.41	-1.8%	13.7%
Standard & Poor's 500	2648.05	2705.27	2718.37	1.7%	12.2%
Nasdaq Composite	7066.27	7442.12	7510.30	8.8%	22.3%
Gold	1313.20	1305.35	1250.45	-3.6%	0.7%
Unemployment rate@	4.10	3.90	3.80	-7.3%	-11.6%
Consumer price index@	249.60	250.50	251.60	2.0%	2.8%
Index of leading ind.@	109.00	109.30	109.50	2.9%	6.1%

— 3rd, 4th, 1st quarter @ — Mar, Apr, May Sources: *Barron's, Wall Street Journal*

Past performance is not a guarantee of future results.

18-Month Summary of Dow Jones Industrial Average, 3-Month T-Bill & 20-Year Treasury Bond Yield

January 2017 to June 2018



News and Announcements

A Tax-Planning Mentality

While it can be easy to think tax planning is synonymous with tax preparation, each serves a different function. When you plan for taxes throughout the year, you can make decisions that may save you tax dollars. By the time you get to tax preparation — when it's time to file your taxes — it's too late to do much that can lower your tax bill. That's why it's best to have an all-year mentality when it comes to tax planning.

Early in the year, take time to assess your tax situation and take steps to become better informed about ways to reduce your tax bill, like doing self-research or speaking with a tax professional. Consider the tax consequences throughout the year before making important financial decisions and transactions. In the fall, take another look at your situation and give yourself enough time to implement any additional tax-planning strategies before the end of the year.

There are three main strategies to reduce your income tax bill:

- Reduce or eliminate taxes by receiving income in a nontaxable form or utilizing all applicable deductions, exemptions, and credits.
- Postpone the payment of income taxes until sometime in the future, mainly through the use of tax-deferred retirement accounts.
- Shift the tax burden to another individual, primarily through the use of tax-free gifting to children or other individuals.

By taking the time throughout the year to assess your tax situation and plan accordingly, you can ensure you won't look back and regret not implementing small changes that would have lowered your tax bill.

Please call if you'd like to discuss this in more detail.

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