Dorchester Advisors
Money worked harder

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Things You Control

Tax Bracket Management for your investments

The Boring opening:
The US Tax laws are "progressive" – this means that people who make more are taxed at a higher rate. The higher rates occur in different income brackets and are clearly described (and updated) each year by the IRS. And to complicate things, these brackets are different for regular income and for capital gains. (No tax related discussions can be reduced to a simple sound bite. Alas).

The profitable part:
Proactively managing your tax brackets creates tax management opportunities for investors, but particularly retired accredited investors. (The IRS defines Accredited Investors as those who meet a certain thresholds for income and assets). But, these opportunities are often counter intuitive. They are counterintuitive because they cause you to prepone paying your taxes to enjoy lower taxes in the future. This flies in the face of the deep-seated view to pay taxes as late as possible. So, it's important to grasp the concept and determine if it applies to your situation.

The thinking that got us to where we are is not the thinking that will get us to where we want to be.
Albert Einstein

The concept is that your pre-retirement economic path puts you in a tax bracket that tends to remain quite stable. But when you are in the retirement transition years, there are often many situations that put you – temporarily – in a lower tax bracket. This is a very good time to evaluate if investment gain harvesting or Roth conversions are right for your situation.

Investment gain harvesting is plan-fully taking gains on selected investments while you are in a temporary lower bracket, so your future gains and hence your taxes on these will be a little lower when you return to a higher tax bracket.

A similar thinking applies to Roth conversions. Media and the Industry seem to suggest these are good for everyone. In my experience, they are situation dependent. Surprisingly often, they are not useful. And more often, even if they are useful, the overall savings may not be worth the effort. **But**, if they work in your situation, they can be valuable indeed.

And of course, Tax loss harvesting is effective, but you do run out of losses to harvest quite quickly. If your portfolio continues to generate a steady stream of losses to harvest – perhaps your problem lies elsewhere?

As always, we encourage you to consult with your tax advisor before implementing any tax strategies.

Why Things You Control are Important

In Investing (as in Life) we can: hope, worry or plan.

I believe that when we hope or worry, we are largely looking at the future and are focused on things we do not control. We hope the markets will get higher and we will make money. Or we worry that markets will collapse and we may lose all our money. And yet, deep down in our hearts, we know that whether our thoughts are optimistic or pessimistic they simply do not influence future outcomes.

We can also look at the future plan-fully. When we do this we tend to focus on the things that we do control. And, by picking activities that are in our control and that are important to our future we have a far better chance of achieving our goals. Of course, life holds few guarantees! So, for example, while we all hope that our favorite stock pick will be a high performing stock, not implementing a properly diversified portfolio is plainly irresponsible to our financial well-being.

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Founder and Investment Advisor

Our Financial Planning Principles

Without a Purpose, accumulating money can become a soul-less task. A financial plan gives your savings a purpose.

It's OK to be broke when you are young - not so when you are old: Studies show that people typically tolerate risk and uncertainty better when they are younger.

Getting down from Mount Everest is as important as getting up: Pay as much attention to accumulating money before you retire as you do to consuming it after you retire.

Planning is life-stage dependent: The principles of saving and investing money in your early years are very different from the techniques that you use in retirement to generate a reliable income stream.

Financial confidence comes from being on top of your taxes, protecting yourself from risks, having a clear picture of your investments and debt, and specific targets for saving and spending.

Achieving financial independence requires a careful balancing of Income, expenses, taxes, and savings. This balancing act (planning) is not intuitive, nor can it be done well on the back of an envelope, but effective plans do give more peace of mind.

Identify your true risks (in contrast to investment volatility, labelled as risk, or uncertainty) and take action to manage them using the correct risk management tools. Pick the right tools for the job - investments won't manage the risks you face, risk products (insurance) won't deliver the growth and flexibility you need.

Taxes remain important even after you retire. However, in retirement your investments become the principal source of your income and hence drive your taxes.

In matters of health: it's your body but your doctor knows better how your body works. So it is with your money: A partnership with an advisor will help you to reach your financial goals - you save, they help your savings grow. Together you can get there faster.