

# Get the Most Out of Your Taxable Accounts

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**A** *taxable account* is simply any account whose use doesn't give you a tax advantage. It can be a savings account, checking account, brokerage account, mutual fund account, or many others. The key is that income and gains generated by the investments held within the account are taxed.

Most people use taxable accounts almost daily for one main reason: they're flexible. Generally, there are no restrictions or penalties to their use. Any restrictions or penalties that do exist are tied to your investment choice, not your account.



Taxable accounts are good bets for everyday use or as a temporary holding spot while you determine your approach. They may also make sense as a part of a more complex tax strategy because taxable accounts may provide tax diversification for your portfolio.

## *Diversify Your Holdings*

Social Security and Medicare projections are grim, yet income tax rates are at historic lows. Change may be on the horizon. Then again, income tax rates could remain stable for some time. Much depends on the outcome of political races. The only thing that's clear is that your future income tax rate is uncertain.

As you choose your taxable accounts, the solution is to tax diversify. Different types of accounts have different tax consequences, and because your future tax rate is uncertain, it makes sense to have at least some of your assets in each of the three major tax buckets:

- ✓ **Pre-tax — 401(k) and traditional IRA:** Here you're betting your tax rate in retirement will be less than your tax rate now. In retirement, the ideal time to draw funds is in years where your income need is lower or you have deductions that reduce your taxable income.

✓ **Post-tax — Roth 401(k) and Roth IRA:** With Roth accounts, you make the opposite bet: Your tax rate now is less than it'll be in retirement. When withdrawals from your tax-deferred account will place you into a higher tax bracket, you can pull money from your Roth account instead for tax-free income, keeping yourself in a lower tax bracket.

✓ **Taxable — long-term capital gains:** Taxable accounts aren't a gamble on income tax rates, but they provide flexibility in drawing cash in retirement. Under current law, gains are taxed at just 15 percent when realized after one year, and unrealized gains aren't taxed at all. You should use taxable accounts to generate growth with unrealized capital gains. (A gain is *realized* when you sell an investment at a profit; if the investment has gained value but hasn't been sold, then the gain is *unrealized*.)

Taxable accounts can potentially provide “tax-free” income in retirement. In years with capital losses, you can offset your realized gains with those losses and take the cash tax-free. You may even be able to deduct up to \$3,000 of losses against your income.



Using taxable accounts to tax diversify your holdings makes the most sense when you've already contributed the maximum to tax-advantaged vehicles. The added flexibility of a taxable account is unlikely to outweigh tax-advantaged growth for a long-term investment.

## Know the Different Types of Taxable Accounts

You can invest in three basic types of taxable accounts:

- ✓ **Individual:** An account established for one person
- ✓ **Joint:** Any account owned by two or more people
- ✓ **Custodial:** An account created for the benefit of a minor

### Going solo with individual accounts

If you're not married, the individual account will likely be the type of account you use. With an individual account, you're the sole owner and have complete decision-making authority. In the event of your death, the proceeds from an individual account pass to your estate.

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### *Getting together with joint accounts*

Married couples or related persons typically use joint accounts for convenient access so they can manage their financial affairs together. You don't have to be married or related, however, to use a joint account. Table 32-1 shows the two most common types of joint accounts.

<b>Table 32-1</b>		<b>Joint Accounts</b>
<b>Category</b>	<b>Joint Tenancy in Common</b>	<b>Joint Tenancy with Right of Survivorship</b>
Owners	Two or more unrelated parties	Two or more unrelated parties
Division of ownership	Unequal ownership is permitted.	Ownership must be equal.
Transferring one's stake	Each owner can sell, will, or gift his or her stake to another.	At death, the decedent's share of the account passes to the surviving owners equally.

### *Taking care with custodial accounts*

*Custodial accounts* are accounts established for the benefit of a minor and are generally opened under the Uniform Gift to Minors Act (UGMA) or the Uniform Transfer to Minors Act (UTMA). The minor is considered the owner of the account, but a custodian must be in place to manage the account.

All funds transferred to the account are considered irrevocable gifts and must be used for the minor's benefit. When the minor reaches the age of majority, the recipient can do what he or she wants with the funds.



Custodial accounts provide irrevocable gifts to a minor. If you act as custodian, you'll manage the funds for the minor's benefit until the minor reaches the age of majority and receives full authority over the funds.