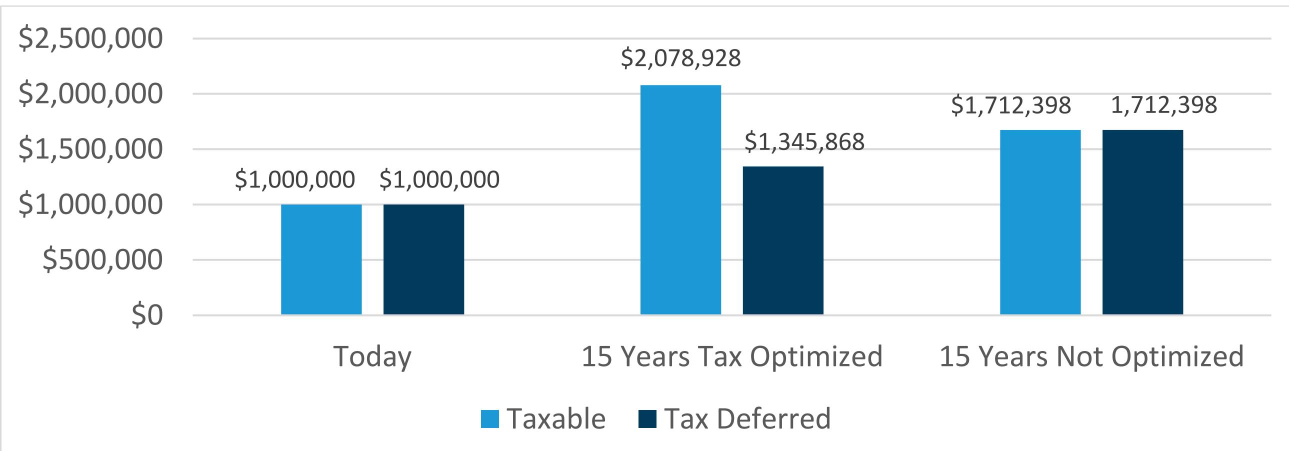
Tax Optimization

Tax optimization is an important portfolio management strategy that Virtue Asset Management implements. Proper tax optimization can take advantage of tax loss harvesting, allowing the donation of appreciated stock to charity and most importantly there is the potential for large tax savings during the life of the client and at death. In this scenario we will look at the difference between a tax optimized portfolio and a simple portfolio that is not optimized.



Assumptions

- $2,000,000 example
- Tax Optimized example portfolio has $1,000,000 in stocks in the taxable account and $1,000,000 in bonds in the tax deferred account
- Not Optimized example portfolio has $500,000 in stocks and $500,000 in bonds in both taxable and tax deferred account
- Equities appreciate at 5% a year in this example
- Fixed Income appreciates at 2% a year in this example
- This is a 15-year scenario
- No assets are withdrawn over this period
- Proceeds for the taxable account will be taxed at capital gains rate: 23.8% is the highest current long-term federal tax rate
- The Required Minimum Distribution (RMD) will be taxed at income tax rate: 43.4% is the highest current federal income tax rate

Results

- In the Not Optimized example portfolio an investor will have equal amounts in both accounts.
  - The client will have $1,712,398 in the Tax Deferred Account
    - At age 70.5 the client will be required to start taking his RMD and in this example the RMD amount is $62,496.29
    - At the highest current federal income tax rate, the taxes are $27,373.37
  - The client will have $1,712,398 in the Taxable Account

- In the Tax Optimized example portfolio, the taxable account ends up with the larger value because of the 100% weighting to equities
  - The client will have $1,345,868 in the Tax Deferred account
    - At age 70.5 the client will be required to start taking his RMD and in this example the RMD amount is $49,119.27
    - At the highest current federal income tax rate, the taxes are $21,317.76
  - The client will have $2,078,928 in the Taxable Account

Conclusions

In this example, if the client has an RMD in year fifteen the federal income tax savings between the optimized portfolio and the not optimized portfolio is $5,805.63 in year one. Even more savings will be achieved at death. After death, the tax deferred accounts will transfer to beneficiaries. The beneficiaries are required to take required minimum distributions based on their age and pay their federal income tax rate. The difference in ending market value between the tax deferred optimized and not optimized portfolio is $366,530 *before taxes*.

After death, the beneficiaries will receive a step up of cost basis in the taxable accounts. This means when they sell the investments, they will be taxed as if they bought them for what they were valued on the day the client died, not the price the client bought them for. In our example, the tax optimized taxable portfolio provides the beneficiaries $366,530 more in market value that would receive a step up in cost basis.

If the beneficiaries in this scenario needed the money from the taxable and tax deferred immediately the $366,530 difference in the tax deferred accounts would shrink to $207,456 after paying the maximum federal income tax rate of 43.4%. Fortunately, the tax optimized taxable account would pay no taxes. This leaves the tax optimized portfolio with an additional $159,074 for the beneficiaries the day after death.

	Beginning	Ending	Taxes*	Final
Tax Optimized				
Taxable	$ 1,000,000	$ 2,078,928	$ -	$ 2,078,928
Tax Deferred	$ 1,000,000	$ 1,345,868	$ 584,107	$ 761,761
	$ 2,000,000	$ 3,424,796	$ 584,107	**$ 2,840,689**
Not Optimized				
Taxable	$ 1,000,000	$ 1,712,398	$ -	$ 1,675,349
Tax Deferred	$ 1,000,000	$ 1,712,398	$ 743,181	$ 969,217
	$ 2,000,000	$ 3,424,796	$ 743,181	**$ 2,681,616**

*assuming the tax deferred account is completely liquidated and pays the 43.4% maximum federal tax rate

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Information presented is based upon good faith assumptions of rates of return, tax rates, portfolio composition and size, time horizon, required minimum distributions, and related criteria. Please be advised that such assumptions may be materially different than actual results and that there can be no assurance that such assumptions will remain valid given the dynamics of a client's individual circumstances and changes in the equity and fixed income portions of the portfolio as well as turnover and tax basis. Also, please note that even small variances in assumptions can have a profound impact on actual results. This information is provided for informational purposes only and is not intended as personalized investment advice. Please consult with your Virtue Asset Management representative concerning your specific circumstances.

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