The INVESTMENT LETTER

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It's Not What You Earn, It's What You Keep

Paying taxes is an inevitable part of life. Though many taxes go to a noble cause – to improve a functioning society – nobody wants to pay a higher tax bill than required. Tax implications are also a significant consideration when investing. In most cases, taxes are the largest expense investors will incur over the course of their investment horizon.

At Investment Counsel, we utilize tax-efficient strategies that can help keep more dollars in our clients' pockets. There are three ways our firm helps client's reduce their tax bills. First, by using a buy and hold approach that converts gains from "short-term" to "long-term." Second, by employing a buy and hold approach that defers out payment of taxes and allows a larger percentage of the investor's principal to compound over time. Third, by constructing portfolios that produce income from dividends, which receive favorable tax treatment compared to income from bonds.

Convert Gains From Short-Term to Long-Term

Tax laws are more favorable to investors who employ a long-term strategy. Capital gains are any profits made from the sale of a stock or bond. When investors hold a stock or bond for less than a year, the profits are considered short-term capital gains. These gains receive no special tax treatment and are taxed at the investor's ordinary income rate. On the other hand, when investors hold a stock or bond for more than a year, the profits are considered long-term capital gains and are often taxed around half the rate of short-term gains.

At Investment Counsel, we emphasize a buy and hold approach that converts gains from "short-term" to "long-term." Using this approach, if our clients do sell their securities, they are taxed at a much lower rate. Trading costs and fees are also significantly reduced using this approach, further bolstering client returns.

Defer Taxes to Allow More Principal to Compound

Tax laws allow investors to defer paying taxes until the security is sold. Investors can therefore control when, and how frequently, they pay taxes on investment gains. By holding securities for longer periods of time, investors pay taxes on a less frequent basis.

At Investment Counsel, our buy and hold approach allows clients to defer taxes for long periods of time. By doing so, our clients' pay taxes less frequently, which allow more of the principal amount invested to compound over time. With more money compounding, clients' tend to see higher net returns over time.

It is also possible to eliminate capital gains tax altogether. This can occur when holding a security until death, and then transferring the security to an heir through proper estate planning. In this case, the heir receives what is known as a "stepped-up" cost-basis, which can eliminate any capital gain tax liability for the heir.

Invest in Dividend-Producing Stocks for Income Needs

Some investors seek income from their investments, typically through dividend payments from stocks or interest from bonds. These proceeds are taxed at different rates. Interest payments from bonds are generally taxed at the investor's ordinary income tax rate. On the other hand, qualified dividends receive more favorable tax treatment and are taxed at the long-term capital gain rate, potentially reducing taxes by around half.

Investing in bonds does have its benefits. Bonds may provide proper diversification and tend to have less volatility associated with them. However, when it matches with the client's investment risk tolerance, Investment Counsel will invest in stocks that deliver high dividends, rather than bonds, for clients who may require income. By doing so, clients can receive income at a more favorable tax rate.

Conclusion

A tax-efficient investment strategy harnesses the tax law to limit taxes and therefore increase net returns. Creating tax-efficient investment portfolios is an on-going process. It requires careful consideration to the investor's unique situation and investment vehicles. It also often requires coordination with tax professionals to ensure proper treatment under tax laws.

Still, the importance of creating investments that have low tax liabilities cannot be stressed enough. It may be hard, if not impossible, to predict market behavior consistently over a long period of time. However, investors can control the tax implications of their investments.

At Investment Counsel, we have always focused on high quality securities that are leaders in their industry and are in position for long-term growth. We also offer low management fees compared to industry standards. Finally, we employ an investment strategy that focuses on minimizing tax consequences for our clients, which focuses on each client's unique situation. With these goals in mind, we believe our clients have the highest probability of keeping more of what they earn. ■

Investment Counsel News

Inside the Office

Thank you for those contributing to our recent survey. We are compiling the feedback and look forward to reporting the results soon!

Outside the Office

Chris and his wife, Barbara, recently enjoyed some time in Puerto Rico and witnessed this double rainbow.