BALLENTINE *Briefs*

FOCUSING ON THE BOTTOM LINE

Investing in a tax-efficient way.

PROBLEM

Wealthy individuals have the unique ability to pursue investment strategies similar to traditional institutional investors, such as endowments, but have the added challenge of considering the tax impact of their choices. This impact can be significant, and 2013 tax law changes increased the burden materially. These changes included an increase in the highest marginal tax rate on ordinary income from 35% to 39.6%, an increase in the highest tax rate on capital gains and qualified dividends from 15% to 20%, as well as a new 3.8% surtax on net investment income for high earners. All of this is before consideration of state taxes, which can be significant!

SOLUTION

We structure our investment approach to promote tax efficiency in client portfolios, which reflects the reality - that investment return after taxes and other costs is what really matters. We use a range of strategies to do this, tailoring them to each client's specific requirements and tax situation. Our approach in one specific case illustrates what we do across our client base:

- Investment selection: Evaluated investment vehicles in each asset class on their expected after-tax returns and selected those that reduce the tax drag of that portion of the investment portfolio.
- Asset location: To the extent possible, placed tax-inefficient investments, such as REITs, in tax-sheltered accounts, such as IRAs.
- Loss harvesting: Regularly monitored portfolios to take advantage of opportunities to sell positions at a loss and reinvest in similar securities. This was done throughout the year rather than only at year-end to maximize the effectiveness of this strategy. We realized $8 million in losses from 2006-2014, generating tax savings of $2.4 million for this client.
- Proactive cash flow management: Continually monitored expected cash flows in order to keep sufficient reserves and managed the need to sell securities with embedded gains more effectively.

RESULT

Each wealthy investor has a unique tax situation, but incorporating active tax planning in the investment process is significantly beneficial. In this case, our client experienced only 0.30% in performance lost to taxes over a 7.5-year period (defined as the difference between cumulative pre-tax return and cumulative after-tax return). As a comparison, if our client had instead invested his entire portfolio in a balanced mutual fund, the estimated performance lost to taxes would have been 7.4%.

Our focus on tax efficiency does not stop at investment management. For example, through our financial planning efforts, we saved this client an estimated $16.4 million in estate and gift taxes through tax-efficient wealth transfer techniques over the same period. These investment and financial planning strategies are core to our work with wealthy families and realize sizable benefits over time.

While tax reform is on the table in Washington, until any changes are a reality, investors still need to pay close attention to this issue.

Boston Area Headquarters | Palm Beach, FL | Lakes Region, NH | Seacoast Region, NH
ballentinepartners.com | 781.314.1300

BALLENTINE PARTNERS

Disclosure Information:

This story was written by Ballentine Partners. It is not a testimonial or endorsement. While this story is based on a real client situation, we have altered some of the details to protect confidential information. No portion of this story should be construed as a guarantee that any other person will experience a certain level of results or satisfaction if Ballentine Partners is engaged, or continues to be engaged, to provide services.