

Five Tax Must Do's During A Down Market

April 16, 2020 / By Debra Taylor, CPA/PFS, JD, CDFA, Wealth Manager

It is so captivating to watch the market action (quickest peak to trough in history, 20 day bear market), that it is easy to forget the forest when you are in the weeds. But, remember the forest we must. So, drag yourself from the headlines, and review the following items and start to perform these high value activities.

1. TAX LOSS HARVESTING

Thanks to an incredible bull market over the past ten years, you had little opportunity to do tax loss harvesting. Now is the time! One of the silver linings of investment losses is the ability to recognize those losses to offset future capital gains and thus, avoiding capital gains taxes in the future!

Professional portfolio managers consider market declines as an opportunity to upgrade their portfolios. Evaluate portfolio strategies and consider selling your dogs and buying shares of your gold medal companies at a lower price. If ABC company made sense at \$100 per share, then it should make even more sense at \$75 per share.

If you need cash, and are going to draw from your portfolio, think carefully about which stocks you can sell to generate losses to be used now or later. Make today's lemons next year's lemonade.

ACTION PLAN: Create a list of all tax losses over a certain dollar amount and look to see whether it makes sense to do some tax loss trading across models or within your portfolio.

2. MAKE GOOD USE OF THE RMD HOLIDAY IN 2020

With the IRA allowing you to forgo your RMDs for this year, get creative in how to benefit from this unexpected gift. By forgoing RMDs, you are enabling your accounts to rebound in value. This could be a simple but effective strategy.

Thinking further, skipping RMDs may drive you into a lower tax bracket, allowing sales of appreciated stock or other assets, or distribution planning to take place (as we mention below). Also, the absence of RMDs makes Roth conversions that much more attractive. Consider the opportunities that a lower tax rate can mean for you, and take advantage of it in 2020.

Action Plan: Consider now how you can benefit from no RMDs in 2020, and understand your opportunities, such as Roth conversions, Distribution Planning or selling that highly appreciated stock. Or simply, putting your RMDs on hold for this year.

3. SPRUCE UP THE PORTFOLIO, REVIEW TAX RETURNS AND DON'T FORGET ASSET LOCATION AND DISTRIBUTION PLANNING

You can save substantial taxes by locating investments in appropriate account types. However, sometimes these moves are time consuming or they generate taxable income. Now is a good time to review your tax return (or Holistiplan Report) to discover any tax inefficiencies.

For example, if you are holding stocks that consistently pay out dividends, it is wise to hold those stocks in qualified accounts to avoid paying income tax rates on dividend income. Conversely, muni bond interest income is typically tax free and is more useful in taxable accounts than qualified ones.

You may have addressed these issues previously and concluded that the price to relocate was just too expensive at the time, but we urge you to revisit this analysis. As the market ebbs and more investments lie exposed, you may find pathways for repositioning that were not there in more flush times.

And while you are thinking taxes and portfolios, consider distribution planning for those of you who are following the conventional wisdom and pulling only from your taxable accounts. With potential tax losses and RMDs on hiatus in 2020, you could be enjoying lower tax rates, and therefore this could be a good opportunity to draw down Traditional IRA accounts.

ACTION PLAN: Review your tax returns for tax savings opportunities, including asset location opportunities and distribution planning.

4. REVIEW ESTATE PLANS AND LEVERAGE GIFTS USING DEPRECIATED ASSETS

Finally, now is a great time to revisit gifting and estate plans. In 2020, the annual gift tax exclusion is \$15,000 per individual. But don't stop there. Consider funding Roth IRAs for children and grandchildren who have earned income. For individuals with large estates who have more ambitious plans, funding trusts (such as GRATs), and gifting depreciated assets now could be very beneficial.

And while you are at it, confirm that your affairs are in order. There is nothing like a global pandemic to remind us to update our estate plans. Make sure you have a will, living will/health care directive and (in most instances) a durable power of attorney. For some, a revocable living trust makes sense (if there are homes in several states or unmarried). And remember that you should update your documents when or if move to a different state, or if you go through some other significant life event (remarriage, widowhood, etc).

ACTION PLAN: Update your estate plans as a result of recent tax law changes, among other things. And if you have a sizable estates to discuss substantial gifting and estate planning opportunities.

5. DON'T NEGLECT YOUR HUMAN CAPITAL

We pay so much attention to the stock markets and the economy, otherwise known as financial capital, that we neglect other forms of capital. During times like these you should be reminded to optimize your human capital so that you can maximize your income now and for the future. Some people's human capital is more akin to a bond where they may see consistent income but not a lot of upside. We may consider tenured teachers and police officers in this category. But many of us have human capital that is more similar to a stock where the long term opportunities may be greater, but the short term risk is higher. Now is a good time to assess your human capital and whether you should consider returning to school, learning another language, or a graduate degree to enhance your human capital. The more options you have, the better off you will be. So although dollars may be tight for some, this may be one of the best investments you make in 2020.

ACTION PLAN: Encourage yourself to take this time to enhance your human capital so you can make money in the stock markets and in your careers.

I tell my clients that there are always opportunities in the market, and it is my job to help find them.

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