MAY 2017

Spring is beginning to settle in. Mud season is in full force. Baseball has begun. And it's time for the annual pilgrimage to the accountant. Taxes. Many of us have our own philosophy about taxes, but, in general, we usually agree to their utility. We may support the services our governments provide with our tax dollars but we differ on where we think our government should spend our money.

Putting aside that debate for another day, tax management is one of the key components that we as financial advisors like to spend time in reviewing with our clients. Their individual tax returns are an important source in providing appropriate tax planning.

When reviewing our client's tax returns, we have an opportunity to access what is driving their tax liability. Is it capital gains? Is it earned income? Is the Net Investment Income Tax an issue? Do they need more tax-free income sources?

All excellent points to consider, but I want to focus this letter on capital gains.

First, capital gains can be either short-term or long-term. Short-term gains are realized when an asset is sold before a year has passed and are usually taxed at your personal ordinary income tax rate. In general, we try to limit the amount of short-term gain we incur for you, because your ordinary rate is usually at or higher than the long-term capital gains rates of 15% or 20%.

Long-term capital gains are realized when we sell an asset that we have held for more than one year. Most of you will be taxed 15% on that gain. However, for those in the highest tax bracket (39.6%), long-term capital gains are taxed at 20%.

Then there is the additional Net Investment Income Tax of 3.8% that applies to higher income taxpayers. Many of you may know this tax as the Medicare Tax that helps fund the Affordable Care Act. If you are required to pay this tax, you may pay 18.8% or 23.8% on long-term gains.

So how do we manage realized long-term gains? I think of two particular circumstances: one is normal investment opportunity and the other is working with highly appreciated holdings. Both are taxed at the same rate when sold, but one can incur a much larger gain and as a result you would have to pay a much larger tax.

ADVISOR THOUGHTS

Let's look at the first circumstance. When we buy an asset, we always consider what its top value or target price would be. In other words, at what price would we want to sell it? When we reach that point and sell the asset, we will usually incur a certain amount of gain. These can add up over a year. When we sit down with you during your investment review, we want to consider how much realized capital gains we have incurred. What can we do to manage it, if necessary? We want to be especially conscientious of this amount when we are experiencing a flat or down market.

Many of you are also familiar with the second circumstance. You inherited a stock or two from your parents, grandparents or an especially generous aunt. Or maybe you bought some shares of a company when you were younger and have held it ever since. The appreciation is now usually so large you are reluctant to sell any of it (Gifting is always a great idea, but that is another topic for another day). And because it has grown so large it can dominate your personal holdings.

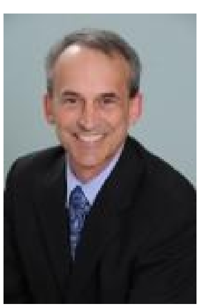
Each circumstance demands a budget, a capital gains budget. Again, a review of your personal tax return is crucial to help us give you good advice that is meaningful to you. Were the realized capital gains this past year manageable, could the number have been higher, should the number have been lower? Are capital gains being generated from a different source, i.e. real estate, or maybe a different investment manager? By understanding your personal tax situation, we are able to take the appropriate action to help you manage an upcoming potential tax impact.

But what about the future of the capital gains tax? Is it going to change in 2017? A new President has moved in to the White House and he and his administration have a much different view of taxes and their impact on you and the economy then our past President. We do expect some changes.

Here is a quick update of what President Trump is proposing regarding capital gains. Please note that these proposals are based on his pre-election tax plans. He is not considering doing away with the tax on gains entirely, but he is looking to limit them. First, he is proposing to shrink the number of tax brackets from the current seven to three, 10%, 25% and 35%. The first bracket would not be subject to the capital gains tax. The second bracket would be subject to the 15% tax on long-term capital gains. The third bracket would be subject to the 20% capital gains tax rate. Of course this is just a proposal at this point. Until Congress takes up a tax reform bill and passes it, the status quo will still be in place.

It is also common knowledge that our President would like to repeal the Affordable Care Act. One of the results of the repeal would be the end of the 3.8% surtax. Due to the repeal's recent failure in the House of Representatives, this tax is also still in place.

So now that Spring is here, consider having your tax returns reviewed. It's important to understand what is driving your taxes and how certain tax management opportunities may help.



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