

Tips for tax-efficient investing

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Considerations to help manage your portfolio's tax exposure



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When I started my investment career at Wells Fargo twenty years ago, investors who were concerned about the impact of taxes on their investment returns in taxable accounts were typically heavily invested in tax-free municipal bonds. Today, investors can consider additional investment options. New tools and technologies assist your investment manager's efforts to manage your portfolio's tax exposure, helping to reduce the potential of an unpleasant surprise at tax time.

Let me give you a couple of examples of why taxes could trip you up:

- It is important to consider how dividends are taxed. Qualified dividends are taxed at long-term capital gain rates. Nonqualified dividends, including payouts from Real Estate Investment Trusts and other unearned income, are taxed at ordinary income tax rates. Higher income taxpayers also may be subject to a potential surcharge on unearned income.
- Timing in purchasing a mutual fund also can have unintended tax consequences. Most mutual funds pass earnings to their shareholders towards the end of the year. You will need to report the distribution from the fund for the whole year on your tax return, even if you purchased the fund just prior to the distribution. High portfolio turnover within the fund also can trigger higher taxes outside of an investor's control.

If not carefully managed, your tax bill may be higher than you have anticipated depending on the types of investments you own. So to keep it simple, are you better off investing only in tax-free municipal bonds to manage your taxes? The answer: not necessarily.

Today investors have the options to consider a full tax-efficient allocation that provides guidance on an optimized portfolio with tax considerations. Investors could also consider gaining exposure to asset classes through tax-efficient investment vehicles such as separately managed accounts, exchange-traded funds (ETFs), and actively managed portfolios that employ tax loss harvesting.

That is not to say that you shouldn't consider investing in tax-free municipal bonds. We see favorable municipal credit fundamentals and believe demand will remain strong in 2026. My point is, consider owning them as part of a well-diversified portfolio in your taxable accounts.

So what should you be discussing with your advisor if you want to help ensure that you're making tax planning a year-long exercise?

- Review your portfolio with your advisor to make sure that it's aligned with your investment objectives — remember that taxes are a consideration, but I don't believe they should drive your investment decisions
- If you are unsure about the investments you own, ask for additional information
- If you are concerned about your tax exposure, ask about tax-advantaged portfolios
- If you are a high-net-worth investor, talk to your advisor about utilizing a full tax-efficient asset allocation strategy as your long-term investment guidance and overlay other tactical guidance

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