



## Five 2010 Tax Tips for a Time of Uncertainty

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While the posturing and political grandstanding continues in Washington over the fate of the Bush tax cuts, tax season is fast approaching. With the time for long-term planning long gone, here are five questions to ask clients that could prompt some smart tax moves in the closing weeks of 2010:

- 1. Do you have capital loss carryovers?** Large capital loss carryovers are a “Get out of (Tax) Jail Free” card that you have to decide when to play. The size of a client’s carryover influences decisions about what positions to sell this year and whether to re-locate various asset classes to taxable or sheltered accounts. For example, if it looks like a client will be hard-pressed to use up his losses, then shift bonds out of his taxable accounts and replace them with equities.
- 2. Do you have short-term gains?** Before year’s end, it’s important to determine whether clients have a net investment gain or loss. Naturally, you want to do all you can to avoid short-term gains. Although you could use capital loss carryovers to offset short-term gains, you also might be able to avoid unwanted gains by monitoring the capital gains distributions of various funds. In cases where there is a gain in a recently purchased fund, do the math to decide whether it’s more beneficial to sell the fund before the distribution happens.

In today’s transitioning market, many investment professionals are practicing more tactical asset management, either as a replacement for a strategic asset allocation or as an enhancement to that model. Because the more frequent trading that results from this tactical approach can generate more short-term gains, advisors must more actively monitor the tax implications of their increased trading to ensure that taxes due on these gains don’t offset the potential benefits from their tactical allocations.

- 3. Do you have losses to harvest to offset gains?** Up to \$3,000 of net capital losses can be deducted from a client’s annual ordinary income, and losses above that can be carried over to future years. “Take losses when you have them” has always been my tax planning mantra and – particularly because I expect capital gains tax rates to increase in the future – stockpiling losses makes even more sense today. Of course, if you sell a position at a loss and are governed by wash sale rules, use an ETF or another mutual fund as a placeholder to maintain market exposure.



- 4. Should you convert a traditional IRA to a Roth IRA?** You can convert a traditional IRA to a Roth IRA at any time, regardless of your income. If a client has had a job loss or taken a family leave, however, this may be a better year to make the switch, since their income is lower than usual. Remember, you don't have to convert the entire account, and you get until October 15 of next year to decide whether you want to re-characterize part or all of a converted Roth account back to a traditional IRA.

Conversion may be a no brainer for wealthy clients in a low tax bracket. Also, clients who don't need the Roth money to fund retirement and want to leave those assets to their children gain decades of tax-free growth from the Roth, as there are no mandated withdrawals.

You can convert an IRA into multiple Roth accounts. For example, for one client, I chose two asset classes already in his portfolio that have relatively low correlations to each other. I'll open two separate conversion accounts and see where things stand next October. I am also planning to convert another portion of the account in January, at which point I'll have 22 months to reassess the situation depending on the performance of the converted accounts.

- 5. Should you contribute to a non-deductible IRA?** Everyone with earned income can make an IRA contribution, but if a client's income is too high and he is covered by a plan at work, he only can make a non-deductible contribution, something that few advisors bother discussing. Remember, however, that you can convert these IRAs to Roth IRAs. In January, a client of mine and his wife (who are both over 50) will each make a \$6,000 non-deductible contribution to an IRA for the tax years 2010 and 2011. We plan to convert those accounts to Roths right away, before any taxes are due. That way, the couple will have \$24,000 tax free for the rest of their lives and into their children's lives.

Some of the standard tax planning advice applies this year, too. If your client thinks he will earn more and be in a higher tax bracket next year, accelerate income and defer deductions – and vice versa if the reverse is true. If clients are planning on making charitable contributions, appreciated stock still makes sense, even if capital gains rates are 15% or 20%.

All this advice could be colored by how Washington handles the impending sunset of the Bush tax cuts. Accordingly, in this uncertain tax environment, it's important to stay on top of developments on Capitol Hill. Your knowledge of the situation and ability to implement some timely tax management strategies will be important value added for your clients.



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