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3 Ways Investment Planning Impacts Your Tax Returns

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Tax Day is right around the corner, and many investors are piecing together how last year's investments will affect this year's returns. This month, Wealth Management Insights reviews three areas where your investment planning and tax returns can overlap.

IRA withdrawals will always trigger a 1099 – even if they're tax-free or given to charity.

*– **Tim Steffen***
Director of Financial Planning

What you should know:

1. Capital gains and losses

- The IRS groups investment gains and losses into short-term (investments held for one year or less) and long-term (those held for longer than one year). To determine if you have a net gain or loss, combine short-term gains and losses, and do the same with long-term gains and losses.
- If your total losses (short- and long-term) exceed your total gains, you can deduct the net loss on your return. Up to $3,000 can be used against your 2015 earned income, with any remaining losses applied to future years.
- Dumping a stock for the tax benefit but immediately rebuying it is disallowed by IRS wash sale rules. Investors must either wait 30 days before rebuying a stock they sold or forgo the tax benefit.

2. Investment management fees

- Investment management fees for an IRA can be paid by directly debiting the IRA – which allows those fees to be paid with pre-tax dollars.
- Another option is to pay IRA fees from a taxable account. Doing so not only keeps more money in your IRA to grow tax-deferred, but it also allows you to take a tax deduction for the expense. IRA fees paid by debiting the IRA itself are never tax deductible.

- The rules for deducting those fees are complicated (AGI limitations apply, and it could trigger the AMT), so be sure of the tax benefit before choosing to pay them from a taxable account.

3. IRA distributions

- Distributions from a traditional IRA should be included in taxable income on your return. If you are paying an early withdrawal penalty tax, you will need to submit additional paperwork as well. (No, the penalty tax is not deductible.)
- If your IRA included after-tax contributions, then a portion of your withdrawal will be a tax-free return of that contribution. Your 1099-R for the IRA withdrawal will show the full distribution as taxable, but the tax-free amount is calculated on IRS Form 8606.
- If you made a Qualified Charitable Distribution from your IRA during 2015, you will still receive a 1099-R for the withdrawal. The withdrawal is reported on your tax return, with a note that it was a QCD. The instructions accompanying Form 1040 have more information.

What you should do now:

While many investors saw relatively modest returns in 2015, even those can increase your tax bill in April. Your Baird Financial Advisor can work with you to keep your portfolio as tax-efficient as possible. ■