

What is Asset Location?

You're probably already familiar with the three most important factors in real estate: location, location, and location. Asset location is a similarly important, if less familiar best practice for keeping as much of your wealth as possible—after taxes have taken their toll. Given how steep that toll can be, it's worth knowing more about how to benefit from proper asset location.

Asset Location: A Definition

Let's begin by noting that asset *location* should not be confused with asset *allocation*. The two are related, but different portfolio management techniques.

Asset *allocation* is dividing your money among different asset class holdings—such as 50% stocks, 50% bonds. The purpose is to create an appropriate balance between seeking higher market returns while managing the risks involved.

Asset *location* (today's focus) is deciding where to hold your various assets among your taxable and tax-sheltered accounts. The purpose is to invest as tax-efficiently as possible.

How it Happens

By locating your least tax-efficient investments in your tax-sheltered accounts, you can minimize or even eliminate tax inefficiencies. For example, typically (but not always!) holdings such as fixed income and REIT funds are less tax-efficient than stocks. And among stock asset classes, some are more or less tax-efficient than others.

It makes intuitive sense to locate these and other asset classes according to their expected tax efficiencies. But it's not as easily implemented as you might think.

First, there is only so much room in your tax-sheltered accounts. After all, if there were

unlimited opportunity to avoid paying income taxes on your investments, you'd simply shelter all of them and be done with it. In reality, challenging trade-offs must be made to ensure you're making best use of your tax-sheltered "space."

Second, it's not just about tax-sheltering your assets. Eventually, you'll also want to spend or bequeath them, so you want to plan for that too. Here are some ideas on how to do that.

- **Managing your bigger picture:** Before deciding where to locate your assets, first determine your proper asset allocation based on your unique goals and risk tolerances. Only then is it appropriate to determine where those holdings should reside for tax efficiency.
- **Planning for your goals and timeframe:** Is retirement near or far? Do you want to leave a legacy? Is your net worth likely to change in the next few years? These spending, estate planning, and other needs may override, or at least influence your optimal asset location.
- **Managing tax-sheltered accounts:** What are your tax-sheltered account opportunities among Roth IRAs, traditional IRAs, and company retirement plans? How much room do you have in each, and which specific holdings in which exact accounts are expected to give you the most tax-efficient outcomes? How might evolving tax codes impact your plans?
- **Considering other tax-planning needs:** We also consider the benefits of holding assets in taxable accounts, such as being able to use foreign tax credits from international investments, harvest capital losses against capital gains, allow your heirs to receive a step-up in basis upon inheritance, and/or donate highly appreciated shares to charity to reduce capital gains taxes.

The Art and Science of Asset Location

While you may not even know if you are missing out on optimal asset location, the resulting wealth unnecessarily lost to taxes can be very real. Here are some reasons your asset location planning may fall short:

- **Missing pieces:** Through the years, families usually accumulate a jumble of individual and retirement plan accounts and financial service providers. As your assets grow, it becomes an increasing challenge to organize them into a cohesive whole.
- **Missing expertise:** Even if you have a handle on all your holdings, effective asset location should be considered within the multiple, often competing components of your total wealth. This calls for multidisciplinary oversight across investment management, tax planning, and estate planning alike.
- **Missing oversight:** Asset location is not a set-and-forget activity. As your own goals, the market, and government regulations evolve, your assets require ongoing management to retain their desired efficiencies.

It's an art and a science to apply effective asset location to your unique, often complex wealth management. That said, the efforts can pay for themselves many times over by minimizing taxes for you and your heirs. Can we answer additional questions? Let us know!

Until next time, no regrets!

David Bromelkamp
President and CEO



FINANCIAL PLANNING TIP:

Tax Efficient Charitable Giving

If you donate cash to charities, you do not receive any tax deduction for these gifts unless you itemize your taxes. Since the Tax Cuts and Jobs Act doubled the standard deduction a few years ago, roughly 90% of taxpayers claimed the standard deduction when filing their 2018 taxes, meaning the vast majority of people do not receive any tax benefit from their charitable giving. Below are two strategies that you can implement to maintain your charitable giving while also receiving a tax benefit.

"Bunching" Donations With a Donor-Advised Fund

If you don't itemize your deductions for taxes, your charitable contributions don't lower your taxable income. One way around this is to "bunch" contributions into one year, allowing you to itemize your deductions and receive a tax benefit. For example, instead of giving \$10,000 per year to charity, you could choose to donate \$50,000 in one year to a donor-advised fund. This would allow you to take a \$50,000 deduction on your taxes for that year, and you can then donate to various charities from the donor advised fund. There is no limit as to how much you can contribute to a donor advised fund, and no restrictions as to how much you can grant to charities from the fund.

Qualified Charitable Distributions from IRAs

If you are over age 70.5, you have the ability to make contributions directly to charities from your IRA via Qualified Charitable Distributions. As you may know, every dollar that comes out of an IRA is an extra dollar to your taxable income. Oftentimes, retirees who need to make Required Minimum Distributions from their IRAs don't need that money for spending. For those that are charitably inclined, you can direct up to \$100,000 per year from your IRA to qualified charities. This results in a 100% tax deduction for the entire amount that was distributed. Learn more on our website [Bunching Contributions](#).

Source: <https://www.taxpolicycenter.org/briefing-book/what-standard-deduction>

Headlines

- Dave Bromelkamp will participate in a Family Impact panel discussion sponsored by i(x) Investments on the topic of Capital Markets, Thursday, June 11.
- Allodium was pleased to welcome three new clients into the firm during the first quarter of 2020.
- Our office will be closed July 3 and September 7 for company holidays.

Note: To find out more about Allodium's breaking news, please visit our website: www.allodium.com.

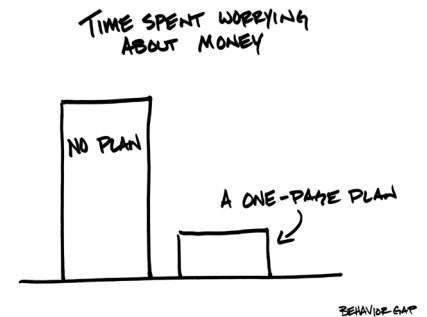
Widespread fear is your friend as an investor because it serves up bargain purchases.

Warren Buffett

Upcoming Events

Allodium Virtual Anniversary Event

Allodium turns 15 in August 2020! Join us for our 15th Anniversary Virtual Event. Details will be coming soon. For more information about this virtual event, please contact Ilona Avraamides at (612) 230-3711 or iavraamides@allodium.com.



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Steward is published quarterly by Allodium Investment Consultants. Please contact Ilona Avraamides at 612-230-3711 or iavraamides@allodium.com if you have any comments about this publication or wish to be added to or removed from our mailing list.



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