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Wealth Management

Welcome to the August 2021 issue of the Peapack Private Planning Quarterly. Planning issues arise at every stage of life—the articles here address a few of them. This quarter, we've focused on issues for and about young adults. The rest of us can view it as a refresher. Please reach out to our authors—or to any of our investment and planning professionals—with your questions. Our guidance can help you achieve your financial goals.

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Click to jump to a desired article

Budgeting for Beginners ▶

Time to Consider a Roth IRA ▶

Don't Forget to Incorporate These Tools into Your Special Needs Plan ▶

Investing for Young Adults ▶

Taxation of Investments ▶

Budgeting for Beginners

Claire E. Toth, JD, MLT, CFP™

Getting that first job out of school is exciting—you're finally a real adult. With that comes responsibility for your own money. How much are you supposed to spend on what, how can you even think about saving anything, never mind about retirement, and what about those looming student debts?

One oft-seen formula is the 50-15-5 guideline: limit essential expenses to 50 percent of after-tax income; save 15 percent of pre-tax income for retirement; set aside five percent of after-tax income for emergencies and short-term savings. Beyond defining what falls into each category, note the mash-up of pre- and post-tax dollars. How does all this work in real life?

Let's invent Stacy, a recent college graduate with a nice job—she'll be making $48,000 annually in a major city near the suburb in which she grew up. Stacy has $25,000 in student loans. She plans to live with some sorority sisters and has hopes of buying a car. Stacy's employer will match as much as three percent of her salary in 401k contributions and will subsidize her medical insurance.

Budgeting for Essential Expenses.

Essential expenses are those that don't go away, even if the job does. That's why a new graduate should keep them under control. To calculate that fifty percent after tax in a perfect world, Stacy would back her projected 401k contribution out of her salary, determine what (if anything) she can contribute to a flexible spending account, calculate Social Security and Medicare taxes, and then pull out the income tax tables. Even with an accounting degree, our hypothetical college graduate isn't going to do that. Instead, ballpark 50 percent of after-tax salary as one-third of pre-tax salary.

Reality comes crashing down: this gives Stacy $16,000 annually, or $1,333 monthly, to spend on: housing, commuting, groceries, medical costs, and student loans. Her student loan will run about $126 per month, leaving her $1,207 to cover other necessities. Stacy may need more roommates than she anticipated, to live in a less hip neighborhood, or even to move back home for a bit. Reducing housing costs gives Stacy the most bang for her buck. Next, Stacy should compare the cost of public transportation versus owning a car. She likely won't need the most expensive medical plan out there. Stacy, like most recent graduates, can expect to scrimp for a while.

Saving for Retirement.

Stacy should know the benefits of early retirement savings. Assume she saves $5,000 per year starting at age 25 for ten years. She doesn't save a dime after that, but her investments grow at seven percent, compounded annually. At age 65, Stacy would have $602,070. To compare, assume Stacy doesn't begin saving for retirement until age 35. She saves that same $5,000 annually, earning that same seven percent, up until age 65—that's thirty years instead of ten. Even though Stacy has set aside more nominal dollars, she has only $546,091 in retirement savings. That's why Stacy needs to begin investing in her 401k plan as soon as she is eligible to do so.

Stacy should contribute 15 percent of her pre-tax earnings annually. Luckily, that doesn't all come from Stacy. Her employer will match 50 percent of Stacy's contributions, up to six percent of salary—three percent. That leaves 12 percent for Stacy to contribute, or $5,760 annually. Because Stacy is young, she should invest for long-term growth, with most (if not all) of her 401k in low-cost equity mutual funds. If Stacy's 401k plan allows, some of her contribution should be to a Roth 401k. She won't get an immediate tax deduction, but all earnings and growth will stay off the income tax grid forever. Stacy's tax rate is likely to increase in the future. Paying a little at a low tax rate now to avoid paying a lot at a high tax rate later is worth the trade off.

Emergency Fund and Short-Term Savings.

Finally, Stacy should establish an emergency fund to cover three to six months of essential expenses, followed by saving up—for a car, a home, a wedding. Given Stacy's monthly budget of $1,333 for essential expenses, she should aim for an emergency fund of about $8,000—that can cover job loss, medical emergencies, or other unexpected expenses. A five percent pre-tax savings target translates to about 3.3 percent after tax—or $132 per month. Even at that rate, it will take Stacy awhile to build up an emergency stash.

Finally, this 50-15-5 calculation isn't just for beginners. The rest of us would benefit from applying it to our own finances, as a check up to see how we're doing.

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Time to Consider a Roth IRA!

Cynthia Aiken, MBA, CFP™

Although there is a lot of uncertainty about future US income taxes, most everyone in Washington expects that future personal tax rates will be higher. To pay for the Covid related federal stimulus, Democrats and Republicans agree that higher tax rates on some or all Americans will be coming. What steps can you take to reduce the bite of future income tax increases?

Tax-free investment growth is one way to reduce the sting of anticipated income tax increases, and Roth IRAs are a great vehicle for growing your money on a tax-free basis. This is particularly true for young adults with low incomes and long time horizons. Let's review the basics.

If you expect to be in a higher tax bracket after retirement, then consider a Roth IRA.

A Roth IRA is an individual retirement account that allows withdrawals on a tax-free basis if certain conditions are satisfied. Roth IRAs were established in 1997 and named after William Roth, a Delaware senator. The key difference between Roth IRAs and traditional IRAs is how they are taxed. Traditional IRA contributions are generally tax deductible (funded with pre-tax dollars), but the withdrawals are taxed as ordinary income. Conversely, Roth IRA contributions are not tax-deductible (funded with after-tax dollars), but the withdrawals are tax-free. If you anticipate higher taxes in retirement, then you should consider funding a Roth IRA. On the other hand, if you anticipate lower taxes in retirement, then a traditional IRA may be better for you. If, like most of us, you have no idea what your retirement tax rate might be, hedge your bets by having both.

Contributions

How much can you contribute? The maximum annual contribution limit for 2021 is $6,000; you can contribute an additional $1,000 if you are 50 or older (total of $7,000). Unlike a traditional IRA, contributions to a Roth IRA can be made at any age if the account holder has earned income. Note – you must have earned income to contribute and you can only contribute an amount equal to your earned income up to the annual limit. That is, if your annual earnings are $3,000, then you can only contribute $3,000.

However, there are restrictions on eligibility to contribute to a Roth IRA. The higher your income, the less likely that you will be eligible to contribute. To contribute the max $6,000 in 2021 ($7,000 if 50 or older) your income must be below $125,000 if you are a single income tax filer or $198,000 if you are married filing jointly. Contribution limits are phased out for singles at $125,000 to $140,000 and for married couples at $198,000 to $208,000.

A little-known tax benefit is the **Saver's Credit**. Singles with annual income of $33,000 or less and married couples filing jointly with income of $66,000 or less who contribute to their Roth IRAs may be eligible for a tax credit of up to $1,000 for singles and $2,000 for joint filers. Not everyone is eligible for this credit, so check to see if you qualify.

Spousal Contributions

If one spouse has earned income and the other spouse does not, the working spouse can make contributions on behalf of their non-working spouse into the non-working spouse's own Roth IRA. The same $6,000/$7,000 contribution limits and income limits apply. However, there are a few requirements for spousal Roth IRA contributions: 1) The couple must be married and file a joint return, 2) The individual making the spousal Roth IRA contribution must have eligible earned income, 3) The total contribution for both spouses must not exceed the taxable income reported on their joint tax return, 4) Contributions to each Roth IRA cannot exceed the contribution limits for one IRA.

Distributions

You may withdraw contributions from your Roth IRA tax-free and penalty-free. Note – these are only the contributions, not the earnings on the contributions. To withdraw the earnings that have accumulated in your account, the earnings must have been generated for at least five years after you initially funded your first Roth IRA account. Additionally, one of the following conditions must occur: 1) Roth IRA owner must be age 59.5 or older when the distribution occurs, 2) Roth IRA distribution must be used toward the purchase of a first home for the Roth IRA holder or a qualified family member, 3) Roth IRA owner has become disabled, 4) Distributions are made to the beneficiary of the Roth IRA after the Roth IRA owner's death.

More on the Five-Year Rule

- If the Roth IRA has been open for at least five tax years:
  - If you are under age 59.5, then earnings are subject to taxes and penalties unless the funds are used for a first-time home purchase ($10,000 lifetime limit), you have a permanent disability, or you pass away.
  - If you are age 59.5 and older, there are no taxes or penalties.
- If the Roth IRA has not been open for at least five tax years:
  - If under age 59.5, then earnings are subject to penalties and taxes. Penalties may be avoided if the funds are used for qualified educational expenses, unreimbursed medical expenses, a first-time home purchase ($10,000 lifetime limit), you have a permanent disability, or you pass away. Taxes still apply.
  - If age 59.5 or older, distribution of earnings is subject to taxes, not penalties.

Exceptions to the Five-Year Rule

Yes, there are a few exceptions and they mirror the exceptions for traditional IRA distribution exceptions: unreimbursed medical expenses, medical insurance payments, qualified higher-education expenses, childbirth, or adoption expenses.

Inherited Roth IRA Rules

If your spouse inherits your Roth IRA, he or she is never required to make withdrawals. Non-spousal heirs must empty the account within a decade. This ten-year distribution rule is the same for both traditional IRAs and Roth IRAs. However, there are a few exceptions to this rule – if the heir is disabled, a minor child of the original owner, or less than a decade younger than the original owner.

Roth 401(k)

Check if your employer has a Roth 401(k) option. With a Roth 401(k), you will contribute after-tax funds into your Roth 401(k), instead of the pre-tax funds into a traditional 401(k). Your paycheck will have different tax amounts, but your contributions will grow tax-free, and your distributions will be tax-free too. If your employer provides matching contributions, then these will go into a traditional 401(k) account. You can contribute up to $19,500 a year to your Roth 401(k) and an extra $6,500 if you are 50 or older. These limits apply to both your traditional 401(k) and your Roth 401(k).

Roth Conversions

If you decide that you want to shift assets from a traditional IRA to a Roth IRA, then you can do a Roth conversion. In the year of the conversion, you must pay taxes on the full amount shifted into the Roth. The funds needed for this tax bill should be held in a taxable account, because withdrawing funds to pay taxes will result in a larger tax bill. Furthermore, review your tax situation with your tax professional before undertaking a Roth conversion, because the funds withdrawn from your traditional IRA for the conversion are counted as income. Additional income could push you into a higher tax bracket or trigger additional taxes. One solution is to take a series of small conversions over several years with an eye to staying in your current tax bracket. Note – once you have completed a Roth conversion, then you must wait five years or be over age 59.5 to withdraw the converted amount penalty free. Each conversion has its own five-year waiting period.

Why Fund a Roth IRA Rather than a Traditional IRA? Taxes!

If you expect to be in a higher tax bracket after retirement, then consider a Roth IRA. Roth IRA tax-free distributions are an excellent technique to hold down your taxes. If you don't need to take distributions from your Roth IRA, then the account can be left to your beneficiaries and they will receive it tax-free. What a generous gift!

Roth IRAs are a powerful tool for everyone and especially for younger and lower income workers who may get the biggest benefit from a Roth IRA. Those with incomes under $125,000 can contribute and invest $6,000 annually in their Roth IRAs – setting themselves up for tax-free earnings and future tax-free withdrawals. Parents can encourage this behavior by offering to match their children's contributions but must keep total contributions under $6,000. A nudge from mom and dad doesn't hurt.

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Don't Forget to Incorporate These Tools into Your Special Needs Plan

Cynthia Fusillo, MBA, CPA, ChSNC®

Having the proper tools in place for protecting both the financial and the social future of your child with special needs is of the utmost importance, and something that cannot be stressed enough. Here we will highlight some of these tools you can think about utilizing to obtain the peace of mind that your child will be properly cared for after you're gone.

Before even focusing on financial issues, a good starting point is the ***Life Plan***, sometimes also referred to as a ***Letter of Intent.*** The goal for your child is to create a system of support that will carry out his/her routine as seamlessly as possible. The more detailed the Life Plan the better it will be. Items to include start with the basics: the child's diagnosis, treatment plan, physicians and other service providers including insurance company, and medications. It should also include social activities. For example, what are your child's favorite things to do and where, such as a park to visit, or other recreational activities he/she enjoys. You might also include a regular place of worship, favorite (or least favorite) foods, and music preferences, to name just a few. The idea is to be as detailed as possible and to capture as much as you possibly can about your child so that, should someone have to step into your shoes as caregiver, there will be minimal disruption to the daily routine. This also serves as a valuable tool in allowing your child to grow as independently as possible given the circumstances. Many also find it extraordinarily helpful to allow various close family members to contribute to this document. Often siblings will have unique insight into what their brother or sister with special needs enjoys just because of shared experiences that may not include parents.

Switching gears to some financial tools, we will discuss ***Special Needs Trusts/Supplemental Needs Trusts (SNTs)*** and specifically of the ***Third-Party***[1] type, ***ABLE Accounts*** and ***Pooled Trusts.*** Regardless of which of these, or combination thereof, you incorporate into your plan, the goal is to safeguard government benefits for which your child can qualify, while maximizing outside assets available to him or her. In other words, used correctly, these tools will allow you to protect your child's government benefits, such as Supplemental Security Income (SSI) and Medicaid, while also allowing them to be supplemented with outside assets.

Third-party SNTs are funded with the assets of someone other than the trust beneficiary. Often these are parents or grandparents, but anyone other than the beneficiary may fund one. The purpose is to provide for the supplemental needs of an individual, as opposed to the basic needs government benefits meet. Drafted most often as "wholly discretionary," it is the trustee and not the beneficiary who has total discretion whether, when, and in what amounts to make distributions. Whereas regular trusts (non SNTs) often have a broad *ascertainable standard* to direct distributions (e.g. for *health, education, maintenance and support…*), SNTs should not use this language so as to not make the trust corpus an available asset of the beneficiary. Doing so would risk disqualification of government benefits. SNTs should always have a spendthrift clause, which provides for creditor protection. While it should be obvious, the beneficiary should not have any powers over the trust such as removing trustees. Transfers to third-party SNTs do not meet the gift tax requirement of being completed gifts of a present interest and will not qualify for the annual gift tax exclusion. Regular trusts (again, non SNTs) get around this by incorporating *Crummey* withdrawal rights. These rights, or powers, are NEVER to be used in a SNT because doing so will make the funds that may be withdrawn available to the beneficiary, once again risking disqualification of government benefits.

[1] Third-party trusts are funded with assets other than those belonging to the beneficiary. When an individual with special needs has assets of his/her own, first-party trusts may be used, but these are beyond the scope of this article. Please consult with an attorney who specializes in drafting these trusts.

Next, and what is thought to be an under-utilized tool, is the ABLE account (created under the Achieving a Better Life Experience Act of 2014). ABLE accounts allow the individual with special needs to have some control and manage his/her own funds, something that is not permissible with a SNT. ABLE accounts are somewhat limited in scope. For example, the special need or disability must have been present prior to age 26, an individual may have only one ABLE account, it can be funded annually up to the gift tax annual exclusion amount (currently $15,000) and, in general, cannot have an account value of more than $100,000 without disqualifying the beneficiary from Medicaid[2]. It is also worth noting that upon the death of the account beneficiary, any remaining funds in the ABLE account must be repaid to the state Medicaid program to the extent of services paid since opening of the account. Permissible expenditures are referred to as *qualified disability expenses*. The expenses must be directly related to the account owner's disability and include broad categories such as education, housing, transportation, health, and wellness. Examples include modifications to a vehicle for a physically disabled driver, or a screen reader for someone who is blind.

Finally, Pooled Trusts are a good option for those without sufficient funds to warrant creating a third-party SNT, the latter of which can be expensive to draft and administer. Pooled Trusts are administered by nonprofit organizations as a collection of smaller trusts rolled into one. As the name suggests, the funds of many grantors are pooled into a larger pot which is then managed and administered by the nonprofit. Your contract with the pooled trust administrator will enumerate the services provided by the nonprofit. Requests for reimbursement are made to the pooled trust; it acts as a trustee would. There are many organizations out there that administer these trusts, so you should investigate and decide which may be right for you based on considerations such as schedule of fees, complexity of the contract, etc.

This article summarized some of the tools available to you when creating a plan for your child with special needs. It is worth mentioning that the rules surrounding government benefits can vary from state to state. For this reason, it is important that you work with professionals who are well versed in the qualifications in your state.

[2] Check with your state for the allowable maximum, which may differ.

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Investing for Young Adults

Coles Romaine, Wealth Analyst

For those of us in our twenties, saving and investing is not top of mind. Instead, we are focused on graduating college, landing our first jobs, or adjusting to a new place to call home. In addition, personal investing may seem complicated and confusing. To break the ice and begin investing, lets walk through considerations that people may have before they start investing.

First and foremost, the earlier you start, the better off you are. Starting an investment program in your twenties will increase your chances of enhancing your future financial condition. Vanguard developed a report comparing account balances for those who start saving and investing in their twenties against those who begin in their thirties. If a 22 and 32-year-old both make a single investment of $5,000 each with an assumed rate of return of 7%, the 22-year-old will likely have a balance that is nearly twice the size of the 32-year-old when they each reach retirement age. Compounding accounts for the large difference in account balances between these individuals. Compounding refers to the increasing value of an investment due to the interest earned on both your initial investment and the accumulated interest since the initial funding date. Investing early and consistently will ultimately put your future self in a better financial position.

To get started on your investment journey, you will need to open an account. This can easily be done online with a brokerage firm such as Fidelity or Charles Schwab. These companies will provide you with the ability to invest in the market as well as offer tools to research securities and funds. Before choosing a brokerage firm, conduct your own research to see which company is the best fit for you.

Many new investors are unsure where to start with security, ETF (exchanged traded fund), or mutual fund selection. To overcome investment hesitation, walk yourself through the following steps. First, think about spreading your savings into different "buckets" to minimize your portfolio's risk and volatility, which is known as asset allocation. The main buckets of assets consist of equities (US, international, and emerging market stocks) and fixed income (US, international, and corporate bonds). Equities offer you potential growth but are considered to have more risk. Fixed income is considered less risky as the potential growth is limited, but it can offer you a steady stream of income. Decide what asset allocation is right for you by determining how much of your savings will go into each bucket. For example, if you are 25, you can invest 75%-85% of your portfolio in equities and 15%-25% in fixed income. The best way to gain exposure to these assets classes is with a mutual fund or ETF (exchange traded fund). An index fund will allow you to participate in the market at a low cost. Putting all your savings in a single stock may be exciting, but ultimately extremely risky. Diversifying your portfolio with a thoughtful asset allocation will protect you on your long-term investment journey.

You should also be aware of the two different types of accounts and the importance of balancing between the two. A brokerage account can be used for non-retirement savings. Think of your brokerage account as savings for various opportunities or large expenses that occur before retirement such as a home purchase, wedding, car, etc. Think of retirement accounts as long term savings and funds that you will not access until you retire. Be sure to utilize your employer 401k plans for retirement savings. If your employer offers a Roth 401k feature, be sure to take advantage of this as this will grow completely tax free. Aim for a 50/50 split in retirement and brokerage savings.

You should define and then commit to a saving / investing schedule. Determine a dollar amount you are comfortable with and willing to save annually, divide that amount by 12, and at the beginning of each month invest it. To ensure that you follow your strategy consistently, pay yourself first. This means that with every paycheck you receive, take a portion of that income, and pay yourself to invest in your portfolio. This strategy of systematic investing is called dollar cost averaging, which consists of investing on a periodic basis with the same purchase amount. It is not chasing market trends or the hottest new company stock, but a slow and steady way to gain exposure to the markets and participate in the long- term gains. This strategy reduces your risk, while also increasing your comfort and investing efficiency. After you repeat this process a few times and begin to get comfortable with your strategy, you can put this plan on autopilot.

Takeaways

- Open an online brokerage account for taxable investing.
- Fund your employer 401k (or Roth 401k) for tax deferred retirement savings.
- Determine your asset allocation (between equity and bonds).
- Research low-cost mutual funds or ETFs (think Index funds for low-cost exposure to the markets).
- Start investing early, even if it is only a small amount.
- Create a systematic investing schedule and pay yourself first.
- Reach out to an advisor to help get you started.

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Taxation of Investments

Gregory D. Sawicki, CFP™, CPA, PFS

The subject of income taxes is always at the forefront investors' minds. This holds particularly true today as many of President Biden's proposals would materially impact the taxes that high income earners pay on their investment income. A smart investor can improve their after-tax investment returns by carefully planning the type of investment and the length of time that it is held, as well as by utilizing tax-advantaged investment accounts. This article is an introduction or refresher of how the various types of investment income are taxed under current law so that we can better understand how potential changes could impact our tax returns in the future.

When is Investment Income Taxed?

As a general rule, investment income is taxed in the year that it is received or when there is no more risk of loss. For example, when you receive a dividend payment from the ownership of a stock or an interest payment from owning a bond, the money received is taxable income. Of course, the tax code is complex and there are always exceptions to the rule. Holding investments in a tax-advantaged account like your company's 401(k) plan or an Individual Retirement Account ("IRA") defers when income is taxed (but more on that later). The type of investment determines how income is categorized and what tax rate applies under the tax code. Investment income generally falls under two categories: ordinary income or capital gain.

Ordinary Income

The distinction between ordinary income and capital gain is important because different tax rates may apply. Ordinary income is any type of income earned that is taxable at ordinary income tax rates. Your wages or salary fall into this category. There are currently seven federal tax brackets for ordinary income and your bracket depends on your filing status (i.e. single vs. married) and your taxable income in that given year. Many investments produce ordinary income. One of the most common types of ordinary income is interest. Interest income from savings accounts, certificates of deposit, money market accounts, and bonds are all usually categorized as ordinary income. However, not all ordinary income is taxable. Bonds issued by state and local municipalities are typically exempt from federal income tax.

Capital Gain or Loss

A second main category of investment income is capital gain. Most assets held for investment purposes fall under the category of capital assets. Typical examples include stocks, bonds, ETFs, and mutual funds. Capital gains (or losses) arise when you sell a capital asset. The amount of the capital gain or loss is calculated based on the difference between the dollar amount you received (or realized) and your adjusted cost basis in the asset. The calculation of your adjusted cost basis can be a complicated one, but it also can be as simple as the cost or price you paid for the asset. The calculation gets more complex if you received the asset as a gift or inheritance. Your cost basis might also be adjusted over time if you reinvest income generated from the asset. An example of this is reinvesting dividend income to purchase more shares of a company's stock.

Capital gains can be subject to preferential tax rates. Two key distinctions in calculating capital gains are realized versus unrealized and short-term versus long-term. Capital gains (or losses) are generally only calculated when an asset is sold and you realize a profit or loss (there are some exceptions out of the scope of this article). The gain or loss on the value of the capital asset while it is still held is called an unrealized gain (or loss). Unrealized income is not taxable income. The length of time a capital asset is held before it is disposed of determines whether it is deemed long-term or short-term. Generally, if you hold an asset for longer than one year, when it is sold your gain or loss will be long-term and subject to lower income tax rates. Depending on your tax bracket, long-term capital gain rates can be as low as 0% and go up to 20% for the highest income earners. Capital assets held for under a year, or short-term assets, are subject to ordinary income tax rates when sold.

If you have sold or realized multiple capital assets during a year, the total creates a net capital gain or loss. The calculation involves totaling up all the long-term gains and losses and short-term gains and losses separately. From an income tax perspective, a short-term capital loss is more powerful because it offsets short-term capital gains, which are taxed at higher, ordinary income tax rates. Once all short-term gains have been offset, short-term losses (if any left) can be used to offset long-term gains. If all long-term gains are also offset, the IRS allows you to lower your earned income by up to $3,000 (if married filing jointly). Net capital losses more than this limit will be carried forward (indefinitely) to be used against future years capital gains.

Dividend Income

Dividend income is another very common type of investment income. Dividends are distributed from some corporations and mutual funds to their shareholders. If the underlying stock is held for more than 60 days and meets some other criteria, the dividend is generally deemed "qualified" and is taxed using the long-term capital gain rates. Otherwise the income is taxed at ordinary income rates.

Net Investment Tax

High income earners may be subject to an additional 3.8% tax on their investment income. This Net Investment Income Tax went into effect as part of the American Cares Act in January 2013 and applies to single filers with modified adjusted gross income over $200,000 and married filers making more than $250,000. Note those income levels are not inflation-adjusted; as time passes, more taxpayers will become subject to this tax. Most common types of investment income including interest, dividends, gains from the sale of stocks, bonds, and mutual funds are all part of the net investment income subject to the tax.

Tax-Advantaged Accounts

Tax-advantaged accounts are generally either tax-deferred or tax-exempt. Two of the most common tax-deferred accounts are traditional IRAs and 401(k) plans. These investment accounts allow for pre-tax dollars to grow tax-free until you withdraw money from the account in retirement. The Roth versions of these investment accounts work differently. You do not receive an initial tax break for contributions. However, the assets grow without tax and are exempt from tax when distributions are taken from the accounts.

While most common investments are completely fine for tax-advantaged accounts, some care must be taken when managing an IRA. Certain prohibited transactions disqualify the IRA's tax-deferred status. Some examples of prohibited transactions are borrowing from or buying property for personal use with IRA funds. Also, a concept called unrelated business income tax or "UBIT" involves the use of leverage or using IRA funds for a trade or business. UBIT can generate taxable income within a tax-advantaged account. Some publicly traded assets, such as master limited partnerships, can trigger UBIT.

Because capital gain assets are taxed more favorably than ordinary income assets, many advisors recommend holding the former in currently taxable accounts and the latter in tax-advantaged accounts. That allows an investor to avoid present ordinary income tax while enjoying the current benefits afforded by capital gains assets.

Conclusion

Tax planning should be incorporated into your investment strategy. Careful considerations on the investment vehicles and accounts utilized, as well as the timing of realizing investment income, can materially impact your after-tax returns. One should always consult their tax advisor as every situation is unique. We will be paying close attention to how adjustments to the current tax code will impact planning going forward.

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