THE Wealth REPORT

Taxes are one of the few guaranteed costs in investing, but how much you owe and when is often within your control. A tax-efficient approach can help you keep more of what you earn, without changing your underlying investment strategy.

TAX-EFFICIENT INVESTING: WHAT IT IS AND WHY IT MATTERS

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Key Takeaways:

- Where you hold an investment matters as much as what you hold. Placing the ideal assets in the ideal accounts can meaningfully help reduce your tax bill over time.
- Tax-efficient investing isn't a once-a-year exercise. Decisions made throughout the year — not just at filing time — may determine how much of your return you'll keep.
- Strategies like tax-loss harvesting, asset location and charitable giving ideally work when planned in advance with a financial advisor, not scrambled together in April.

Overview

Most investors pay attention to returns — fewer pay attention to what's left after taxes. Yet taxes can be one of the largest drags on long-term investment performance as they eat into gains year after year.

Tax-efficient investing is the practice of structuring your portfolio and your decisions to legally help minimize the taxes you owe on investment income and growth. You're not chasing loopholes or taking on unnecessary risk; instead, you're being deliberate about which accounts you use, when you buy or sell and ways you give, so more of your money stays invested and working for you.

Start with Account Type

Not all accounts are taxed the same way, and that difference is the foundation of tax-efficient investing.

- **Tax-deferred accounts** like traditional 401(k)s and IRAs let contributions grow without annual tax drag. You pay ordinary income tax when you withdraw funds in retirement.
- **Tax-free accounts like Roth IRAs and Roth 401(k)s are funded with after-tax dollars, and qualified withdrawals are not taxed again.**
- **Taxable brokerage accounts** offer no special tax treatment, but they also come with no contribution limits or withdrawal restrictions, giving you flexibility that the other two don't.

Health savings accounts are also worth a mention, since they offer a rare triple-tax advantage: tax-deductible contributions, tax-free growth and tax-free withdrawals for qualified medical expenses.

Each of these account types comes with its own annual contribution limit, which adjusts each year. As a general rule, maxing out tax-advantaged accounts before adding to a taxable brokerage account is one of the simplest ways to help build tax efficiency into your plan from the start.

Consider Asset Location, Not Just Allocation

Asset allocation determines what you own. Asset location determines where you own it, and the two decisions can affect your after-tax return in very different ways.

Investments that generate a lot of taxable income each year — such as bonds, real estate investment trusts (REITs) or actively traded funds — are often better suited for tax-deferred or tax-free accounts, where that income isn't taxed annually. Investments that are naturally more tax-efficient, like index funds or individual stocks held long-term, can make more sense in a taxable account, since they generate less annual taxable activity and typically qualify for lower long-term capital gains rates when sold.

Mind Your Holding Period

How long you hold an investment can change how much tax you owe on it. Assets sold within one year are taxed as short-term capital gains at your ordinary income rate, which can run as high as 37%. Hold that same asset more than a year, and the gain typically qualifies for long-term capital gains rates of 0%, 15% or 20%, depending on your taxable income.[1]

Your income level in a given year also affects what you owe. Depending on your taxable income, you may qualify for a reduced (or even eliminated) federal rate on long-term gains. This can make a lower-income year a strategic time to realize gains. Higher earners may also owe the 3.8% Net Investment Income Tax, which is a surtax generally calculated based on net investment income and modified adjusted gross income above applicable filing-status thresholds.[2]

Paying attention to how much you're making and how long you're holding on to assets can be a tax strategy in itself.

Use Losses to Your Advantage

Markets don't move in a straight line, and that volatility can actually work in your favor. Tax-loss harvesting involves selling an investment that's lost value to realize a capital loss, which can offset gains elsewhere in your portfolio dollar-for-dollar. If losses exceed gains, up to $3,000 can offset ordinary income each year, with any remainder carried forward indefinitely.[3]

One rule to watch: The wash sale rule disallows the loss if you buy a substantially identical security within 30 days before or after the sale. This applies across all your accounts, including a spouse's, so coordination matters if more than one person manages household investments.

Give Strategically

Charitable giving can double as a tax strategy when done with appreciated securities. Donating appreciated stock held for more than one year directly to a qualified charity may allow you to generally avoid recognizing capital gains while deducting the stock's fair market value, subject to applicable limits and requirements.[4]

A donor-advised fund can help you bunch several years of giving into one larger contribution, potentially making it easier for your total itemized deductions to exceed the standard deduction in a given year.

Think About Taxes Year-Round

Tax season tends to focus attention on last year's decisions, when the more valuable opportunities usually happen earlier. Here are just a few moments to look at your tax situation throughout the year:

- **When rebalancing your portfolio.** Selling winners to rebalance can trigger gains. Consider whether losses elsewhere can offset them first.
- **When your income changes.** A lower-income year, such as one following a job change or early in retirement, may be a good time to convert traditional IRA funds to a Roth while in a lower tax bracket.*
- **Before year-end.** Loss harvesting and charitable gifts generally must be completed by December 31, while deadlines for contributing to retirement accounts vary by account type. Some IRA contributions can be made through the tax-filing deadline.
- **When you receive a windfall.** Bonuses, inheritances or the sale of a business all create tax decisions best made proactively, not after the fact.

**Converting funds from a traditional IRA to a Roth IRA is generally a taxable event to the extent the converted amount includes previously untaxed contributions and earnings. Increased taxable income from a Roth conversion may have several consequences. Be sure to consult with a qualified tax advisor before making any decisions regarding a Roth conversion.*

The Wealth Report

Final Thoughts

Tax-efficient investors are intentional with the strategies they deploy so they're not paying more than necessary. The strategies above ideally work as an ongoing part of a financial plan rather than a last-minute rush, and the ideal combination depends on your income, goals and time horizon.

Your financial advisor can help you evaluate which of these strategies fit your situation and coordinate them with your broader financial plan, including your tax preparer's guidance on your specific return. Your financial advisor can refer you to local CPAs and estate planning attorneys, if needed.

Sources

[1] Kelley R. Taylor. Kiplinger. March 9, 2026. "IRS Updates Capital Gains Tax Thresholds for 2026: Here's What's New." https://www.kiplinger.com/taxes/irs-updates-capital-gains-tax-thresholds. Accessed July 1, 2026.

[2] IRS. April 2, 2026. "Topic no. 559, Net investment income tax." https://www.irs.gov/taxtopics/tc559. Accessed July 1, 2026.

[3] IRS. April 30, 2026. "Topic no. 550 (2025), Investment Income and Expenses." https://www.irs.gov/publications/p550. Accessed Aug. 4, 2026.

[4] Kelley R. Taylor. Kiplinger. April 10, 2026. "Capital Gains Tax Rates 2026: What You Need to Know." https://www.kiplinger.com/taxes/capital-gains-tax/602224/capital-gains-tax-rates. Accessed July 1, 2026.