PFL Academy

Chapter 68: Tax-Efficient Investing Strategies

Student Activity Packet

THE CHALLENGE

Jamal, age 25, started investing $6,000/year in a Roth IRA while in the 12% tax bracket. His coworker Tyler put the same amount into a traditional IRA for the tax deduction. Both averaged 7% returns over 40 years. At retirement, Jamal's Roth had grown to $1.2 million—100% tax-free withdrawals. Tyler's traditional IRA also had $1.2 million, but he owed approximately $264,000 in taxes (22% rate), leaving him with $936,000. Jamal's tax-efficient strategy gave him $264,000 more—simply by choosing the right account type.

How can understanding tax-advantaged accounts, asset location, and strategic timing help you keep more of your investment returns and build substantially greater wealth?

Learning Objectives

- Compare tax-deferred, tax-free (Roth), and taxable account types and determine optimal usage.
- Calculate the tax implications of capital gains, dividends, and interest income.
- Apply tax-loss harvesting, asset location, and holding period strategies to minimize taxes.

CORE CONCEPTS

Term	Definition
Tax-Deferred Account	Retirement account (traditional 401(k)/IRA) where contributions may be tax-deductible and growth isn't taxed until withdrawal.
Tax-Free Account (Roth)	Retirement account (Roth 401(k)/IRA) funded with after-tax dollars where all growth and qualified withdrawals are tax-free forever.
Capital Gains Tax	Tax on investment profits. Short-term (held <1 year) taxed as ordinary income; long-term (≥1 year) gets preferential rates (0%, 15%, 20%).
Tax-Loss Harvesting	Selling investments at a loss to offset capital gains and reduce taxable income, then reinvesting in similar (not identical) assets.
Asset Location	Strategy of placing tax-inefficient investments (bonds, REITs) in tax-advantaged accounts and tax-efficient investments (index funds) in taxable accounts.

Background: The S&P 500 has returned about 10% annually, but **taxes can erode 20-50% of those returns**. The difference between a 7% pre-tax return and 5% after-tax return might seem small, but over 30 years, that 2% annual difference transforms $10,000 into either $76,000 or $43,000—a **$33,000 difference from taxes**

alone. Tax-efficient investing adds 1-2% to after-tax returns without taking additional risk, potentially adding $200,000-$500,000 to lifetime wealth.

APPLY IT

PART A: ACCOUNT TYPE COMPARISON

Account Type	Tax on Contribution	Tax on Growth	Tax on Withdrawal	Best For
Traditional IRA/401(k)	Deductible	Deferred	Ordinary income	High earners expecting lower retirement tax
Roth IRA/401(k)	After-tax	None	None (qualified)	Low bracket now, higher later
Taxable Brokerage	After-tax	Annual	Capital gains	Flexibility, no contribution limits

Investor Profile: Maya (Age 24)

First job earning $45,000 (12% bracket), expects income to grow significantly. Employer offers 401(k) with 4% match. Can save $10,000/year total.

Priority 1: ______________________________

Priority 2: ______________________________

Because: ______________________________

Investor Profile: Robert (Age 52)

Senior manager earning $180,000 (32% bracket), plans to retire on $70,000/year (likely 22% bracket). No employer match available.

Best account type: ______________________________

Because: ______________________________

PART B: TAX-LOSS HARVESTING SCENARIO

Your taxable portfolio shows the following positions in December:

Investment	Cost Basis	Current Value	Gain/Loss	Holding Period
Tech Stock A	$8,000	$11,000	+$3,000	14 months
Bond Fund B	$10,000	$9,200	-$800	8 months

Int'l Fund C	$7,000	$5,500	-$1,500	18 months

1. You sold other stocks earlier this year for a $5,000 long-term gain (15% rate). Which position(s) should you sell to harvest losses and reduce your tax bill?

Sell: ______________________________

2. Calculate your tax savings from this tax-loss harvesting strategy:

Show calculation: Losses harvested × applicable tax rate

Tax savings: $_________

> **Wash Sale Rule:** *You can't claim the loss deduction if you buy a "substantially identical" security within 30 days before or after the sale. Buy a different fund to maintain your allocation.*

PART C: HOLDING PERIOD IMPACT

3. You bought stock for $10,000 eleven months ago. It's now worth $15,000 (a $5,000 gain). You're in the 24% tax bracket. Calculate the tax difference between selling now vs. waiting one more month:

Short-term tax (24% ordinary income) vs. Long-term tax (15% preferential rate):

Tax savings from waiting: $_________

CHECK YOUR UNDERSTANDING

1. For a 25-year-old in the 12% tax bracket expecting higher income later, the most tax-efficient retirement account choice is typically:

- ☐ A. Traditional IRA (immediate tax deduction)
- ☐ B. Roth IRA (tax-free growth and withdrawals)
- ☐ C. Taxable brokerage account
- ☐ D. All accounts are equally tax-efficient

2. Explain why bonds should typically be held in tax-advantaged accounts while stock index funds can be held in taxable accounts.

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3. Calculation: If optimal asset location adds 0.5% annually to after-tax returns on a $100,000 portfolio over 30 years (7% vs. 6.5% growth), how much additional wealth results?

Calculate: $100,000 at 7% for 30 years vs. $100,000 at 6.5% for 30 years

Benefit of optimal asset location: $__________

4. Why is tax-loss harvesting valuable even though you're "selling at a loss"? What do you do immediately after harvesting?

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5. Reflection: Based on your current or expected tax bracket, which account type(s) would you prioritize? What asset location strategy would you use? What annual tax-efficiency habit would you commit to?

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