PFL Academy

Teacher Guide: Chapter 68 — Tax-Efficient Investing Strategies

OVERVIEW

TIME	MATERIALS	PREREQUISITES
45-50 Minutes	Student Activity Packet	L-47: Investment Types, L-3: Income and Taxes

LESSON FLOW

5 min — **THE CHALLENGE**

- Present Jamal vs. Tyler comparison—same investments, $264,000 difference.
- Discussion: "How can two identical investments end up so different at retirement?"
- Key insight: Tax efficiency is entirely within your control—no extra risk required.

10 min — **CORE CONCEPTS**

- Walk through three account types—draw "tax treatment" comparison on board.
- Emphasize: Roth = pay taxes now at low rate; Traditional = defer and pay later.
- Quick check: "If you're in 12% bracket now and expect 24% later, which is better?"

25-30 min — **APPLY IT**

- **Part A (10 min):** Account selection—focus on current vs. future tax bracket analysis.
- **Part B (10 min):** Tax-loss harvesting—walk through the wash sale rule carefully.
- **Part C (5-10 min):** Holding period calculation—show the dollar impact of waiting.

10 min — **CHECK YOUR UNDERSTANDING**

- Q3 asset location calculation is the key "aha" moment—0.5% adds up massively.
- Q5 personal strategy is crucial—students should leave with a specific plan.

DIFFERENTIATION

Support

- Use simple rule: "Low bracket now = Roth; High bracket now = Traditional."
- Provide pre-filled examples for tax-loss harvesting calculation.
- Focus on just Roth vs. Traditional; defer asset location to extension.

Extension

- Calculate Roth conversion strategies during low-income years.
- Research 0% capital gains bracket and strategic gain harvesting.
- Design complete tax-efficient plan across three account types.

ANSWER KEY

Part A: Account Type Comparison

Maya: Priority 1: Traditional 401(k) to get 4% match (free money). Priority 2: Roth IRA to maximize tax-free growth at low 12% bracket. She's young and in low bracket—Roth makes sense for additional savings beyond match.

Robert: Traditional 401(k)/IRA. At 32% bracket now expecting 22% in retirement, deduction at high rate now and pay lower rate later maximizes tax benefit. 10% rate difference saves significant taxes.

Part B: Tax-Loss Harvesting Scenario

1. Sell Int'l Fund C (-$1,500 long-term loss) to offset part of $5,000 long-term gain. Optionally also sell Bond Fund B (-$800) to offset remaining gains or ordinary income.

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2. Tax savings calculation:
Fund C: $1,500 loss × 15% LT rate = $225 saved
Fund B: $800 loss × 24% ordinary = $192 saved
Total potential savings: $417
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Part C: Holding Period Impact

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3. Sell now (short-term): $5,000 × 24% = $1,200 tax
Wait 1 month (long-term): $5,000 × 15% = $750 tax
Tax savings from waiting: $1,200 - $750 = $450
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Check Your Understanding

1. B (Roth IRA)

2. Bond interest is taxed as ordinary income annually (up to 37%), making bonds tax-inefficient. Stock index funds generate mostly qualified dividends (0-20% rate) and unrealized appreciation you control when to realize. Bonds belong in tax-advantaged accounts; stocks can go in taxable.

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3. $100,000 at 7% for 30 years ≈ $761,000
$100,000 at 6.5% for 30 years ≈ $661,000
Benefit of optimal asset location: ~$100,000
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4. Tax-loss harvesting lets you reduce taxes while maintaining market exposure. Immediately after harvesting, you buy a similar (not identical) investment to stay invested. You get the tax deduction without abandoning your strategy.

COMMON MISCONCEPTIONS

Misconception	Clarification
"Traditional is always better because you get a tax deduction."	Deduction now at 12% but tax at 22% later means you lose. Roth is better when your future tax rate exceeds your current rate. The math depends on bracket comparison.
"Tax-loss harvesting means giving up on losing investments."	You immediately reinvest in similar assets, maintaining your portfolio strategy. You keep market exposure while capturing the tax benefit.
"Taxes don't matter much compared to investment returns."	A 1-2% annual tax drag compounds to $200,000-$500,000 over a lifetime. Tax efficiency is one of the highest-impact, lowest-risk strategies available.