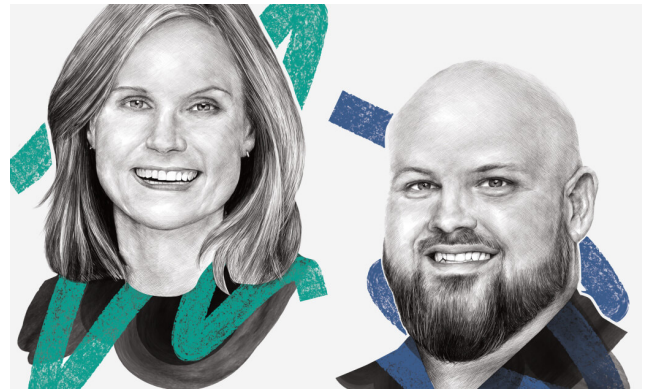


How Advisors and Investors Can Pursue Greater Tax Efficiency

Two seasoned Capital Group professionals share their insights on tax-saving practices for investing.



What's certain about the markets is that no one knows for sure how they will perform in the near or long term. But while advisors have little control over the actual returns of the investments they select for their investors, they do have a fair amount of control over their clients' tax liabilities, provided they make strategic investment choices. Using ETFs—with their innate tax-efficient structure—among other steps, can play a significant role in lowering those bills. Recently, we spoke with Capital Group's Leslie Geller, a senior vice president and wealth strategist, and John Finneran, an ETF sales specialist, who shared some of the practices that advisors should consider for client accounts.

Q: What tax-planning practices are advisors possibly overlooking?

Leslie Geller: Advisors often think about tax planning as something that comes in addition to investment solutions and portfolio construction. But it really should be part of that whole process. Advisors also sometimes overlook the simple things. Everyone gets caught up in the alphabet soup of estate-planning acronyms like GRATs [grantor retained annuity trusts] and CRTs [charitable remainder trusts], and they forget the things that provide a ton of value like gifting, annual exclusion gifts, paying for education expenses and directly funding 529 college-savings plans.

Q: What makes ETFs so tax-efficient in relation to other investment products?

John Finneran: It's the ETF wrapper or structure that allows for the tax efficiency, and it applies to active ETFs as well as passive or index ETF portfolios. In talking with advisors and their clients, we see many of these folks assume it's only the passive ETFs that offer tax efficiency. Mutual funds on average have had a capital gain distribution annually, but ETFs have distributed gains much less often.

Q: Can you explain how the way ETFs trade helps tax efficiency?

Finneran: The first thing to think about with an ETF is that \$6 out of every \$7 traded in an ETF happens on the secondary market such as a stock exchange. It's literally just exchanging existing shares for existing shares, which is similar to when trading an individual company or individual stock. We aren't touching the underlying securities inside the ETF, because all we're doing is matching up buyers and sellers of the ETF shares.

Q: How does tax-loss harvesting help maximize tax efficiency in portfolios?

Finneran: For the bulk of financial advisors, tax-loss harvesting is typically a fourth-quarter concern because that's when clients receive their capital-gains estimates for the year from their advisors. But tax-loss harvesting should be a year-round activity. We're seeing the fastest-growing financial advisors make this at least a monthly review for their clients as part of a tax-

This article was previously published on partners.wsj.com on September 27, 2023. Custom Content from WSJ is a unit of The Wall Street Journal Advertising Department. The Wall Street Journal news organization was not involved in the creation of this content.

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savings strategy. Advisors should be asking, are there gains and losses we can be realizing right now rather than just pushing off to Q4?

Q: What are some other ways ETFs can figure in tax-efficient portfolios?

Geller: Obviously rebalancing portfolios when you're tax-loss harvesting is important: How do you replace the assets that you sell or harvest? Harvesting really offers the opportunity to improve portfolios if you replace assets with ones that are higher investment quality, have lower expenses and are more efficient, or some combination of all these. It's important to pursue long-term goals, and that can be shifting away from individual holdings in favor of ETFs to help improve diversification and lower expenses. Some ETFs can also be a good alternative to cash and cash equivalents, and there's a lot of cash sitting on the sidelines right now. Also, a lot of investors simply reinvest dividends on less tax-efficient investments and are on autopilot with dividend reinvestment. It may make sense to take those dividends and invest them into more tax-efficient vehicles.

Q: Some advisors use fee-based models that are designed to be tax-efficient. How are they setting these up?

Finneran: Some advisors are "outsourcers," handing over the investment management to someone else—a third party—which constructs the models. Other advisors are "customizers." Those folks are maybe outsourcing just part of the investment management. Finally, there are "model builders," who research and build their own models. These advisors tend to work in larger teams with researchers who can help them.

Q: Is tax planning more important when markets are volatile?

Geller: Much about investing is unpredictable. We can't control investment performance or interest rates. But we can exercise some degree of control over our tax bills, and I've been counseling advisors to really focus on active tax planning. That sense of control gives people comfort and agency at a time when things are uncertain and unpredictable.

[Learn how to pursue greater tax efficiency with active ETFs.](#)

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