

5 Strategies for High-Income Earners



When tax season approaches, our big advice: do as the boy scouts do – always be prepared! Proper preparation provides a strong foundation for managing your finances and is arguably an even more critical step for high-income earners. More investments, public and private, and charitable giving all present their own unique tax scenarios. A thoughtful approach using the right strategies can help you mitigate tax liabilities while you build wealth more effectively.

Tax-Efficient Investment Accounts

High-income earners should also consider investing in tax-efficient accounts to minimize tax liabilities. These accounts, like taxable brokerage accounts and tax-managed mutual funds, have advantages and disadvantages.

One of the perks of tax-efficient accounts is they offer many investment options, allowing you to diversify your portfolio effectively. Plus, these investments can generate capital gains, which are often taxed at lower rates than ordinary income. If you hold onto your investments for the long term, you might even qualify for lower capital gains tax rates - a win-win for your tax bill.

Still, much like retirement funds, these accounts have their limitations. There are annual contribution limits, and unlike retirement accounts, there are no tax advantages for early withdrawals. So, while they can be a useful tool in your financial toolbox, they might not be as accessible for unexpected expenses.

Tax-Loss Harvesting

Tax-loss harvesting involves selling investments that have experienced losses to offset capital gains, ultimately reducing your tax liability. This strategy allows you to offset gains from profitable investments with losses from underperforming ones, reducing your overall tax liability. Tax-loss harvesting involves selling investments that have experienced losses to offset capital gains, ultimately reducing your tax

liability. This strategy allows you to offset gains from profitable investments with losses from underperforming ones, reducing your overall tax liability. By minimizing capital gains taxes, you keep more of your investment returns and can reinvest those savings for further growth. Regularly harvesting tax losses can improve the overall performance of your investment portfolio by optimizing your tax situation.

Caution: This strategy does take some work and expertise. Tax-loss harvesting involves actively monitoring your investments and making strategic decisions. It requires a thorough understanding of tax laws and regulations, and mistakes can lead to unintended tax consequences. Unless you are an expert, we suggest you talk to a financial advisor for guidance.

Tax-Advantaged Investments

Investing in tax-advantaged vehicles such as municipal bonds, Health Savings Accounts (HSAs) and 529 college savings plans offers another tax-efficient strategy for high-income earners while providing portfolio diversification. These investments offer the potential for tax-free or tax-deferred growth, allowing your investments to compound more effectively.

Some tax-advantaged investments, like municipal bonds, may offer competitive returns while providing tax benefits.

Tax-advantaged accounts do have some disadvantages. They may restrict the types of investments you can hold, limiting your investment choices, and some have annual contribution limits, which may not accommodate significant wealth accumulation. Depending on the type of tax-advantaged account, there may be limitations on when and how you can access your funds, potentially affecting your liquidity.

Charitable Giving and Donor-Advised Funds

Last but not least, charitable giving can be both fulfilling and a smart tax strategy for those high-income earners with a philanthropic spirit. Donor-advised funds (DAFs) offer a structured approach to charitable giving while providing tax advantages. Donations to qualified organizations can be deducted from your taxable income, reducing your overall tax liability. This allows you to positively impact the causes and organizations you are passionate about while providing tax advantages that get you closer to your financial goals.

There are limits on the number of charitable deductions you can claim, so not all contributions may be fully deductible. DAFs often charge management fees, which can reduce the overall impact of your charitable giving. And, once you contribute to a DAF, the funds become irrevocable and must be used for philanthropic purposes, limiting your control over the assets.

It's important to recognize that there is no one-size-fits-all solution. Your financial situation, goals and risk tolerance will determine which strategies are most suitable for you. Consulting with a financial advisor or tax professional is essential to create a customized tax plan that aligns with your specific needs and circumstances. By proactively implementing these tax strategies, you can optimize your tax liability, preserve wealth, and achieve your financial goals more efficiently.

Maximize Retirement Contributions

Stop us if you've heard this one. A key tax strategy for high-income earners is to max out retirement contributions. That means contributing the maximum allowable amount to retirement accounts such as 401(k)s, IRAs or SEP IRAs. Contributions to retirement accounts are typically tax-deductible, which lowers your taxable income for the current year.

Moreover, the money you invest in these accounts can grow tax-deferred until you decide to withdraw it, allowing your savings to grow over time. As a bonus, some employers offer matching contributions, effectively increasing your retirement savings without additional effort. Barring any highly unusual circumstances, you know maxing out your retirement contribution is a basic tenet of building your wealth. If you're not already doing it, this is your sign to take the steps and get it done.

It's important to remember that there are annual limits on how much you can contribute to retirement accounts, and these limits may not be sufficient for high earners looking to shelter a significant portion of their income. Additionally, withdrawing funds from retirement accounts before retirement age often incurs penalties and taxes, reducing the flexibility of your investments and limiting their use for other financial goals.

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