



Tax Smart Fixed Income Strategies

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Presented by:

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Outline of Topics

- The Real Goal:

Maximize “After-Tax” Total Return

- The Strategies
- Apply the “Correct” Tax Rules
- Do the Math First
- The Importance of Communication

“After-Tax” Total Return

- Total Return = (Ending Dollars / Initial Investment) – 1

$$\begin{array}{r} \text{Coupon Income} \\ + \text{Income from Reinvestment} \\ + \text{Change in Market Value} \\ \hline \text{Ending Dollars} \end{array} \left. \vphantom{\begin{array}{r} \text{Coupon Income} \\ + \text{Income from Reinvestment} \\ + \text{Change in Market Value} \\ \hline \text{Ending Dollars} \end{array}} \right\} \begin{array}{r} \text{Less} \\ \text{Applicable} \\ \text{Taxes} \end{array}$$

- Market Value = Present Value of Future Income
- Total Return Measures the Actual Dollars that pay:
Salaries, Interest, Other Expenses and Dividends

"After-Tax" Total Return

- Measurement Issues
 - ✓ Nominal total Returns Can Be Deceiving
 - ✓ Adjustments are Difficult in Mixed Portfolios

The Strategies

- “Harvesting” Losses
- Taking “Strategic” Gains

The Strategies

- “Harvesting” Losses

- ✓ Selling a Bond at a Loss can Shelter other Gains
- ✓ Reinvest Proceeds and Tax Benefit at Higher Rates

Potential Result: Higher “After-Tax” Total Return

The actual result depends on how well you did your homework...

The Strategies

- “Taking “Strategic” Gains
 - ✓ Strategy will vary for Taxable and Exempt Securities
 - ✓ Take advantage of Long-Term Capital Gains Rates
 - ✓ Match Gains with Realized Losses

Take Bad Dogs to the Pound



The Strategies

- Potential Result:
 - ✓ Higher “After-Tax” Total Return

Read The Fine Print:

Decision and Actual Result depend on
how well you did your homework...

Applying the “Correct” Tax Rules

Some Puerto Rico and US Tax Differences

- Treasuries and some Agencies are Exempt in PR
- Long-Term Gain: Greater than 6 Months in PR
- No Carry-Backs in PR
- Individual Loss Deduction: Only \$1,000 in PR
- Industry-Specific Differences: Banks, Life Companies, etc.

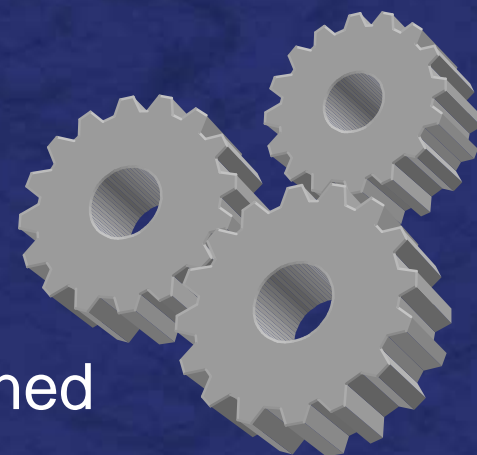
Do The Math First

- Understand the Bond's Embedded Options
 - ✓ They can Hurt you if you don't understand them...
or Help you if the market is mispricing them.
- Know your Tax Status
 - ✓ Marginal Tax Rates,
 - ✓ Existing Realized Gains
 - ✓ Loss Carry-Forward Balance

Do The Math First

- Industry Issues:
 - ✓ Regulatory Capital and Similar Issues
- Know the Yield Curve
 - ✓ Slope
 - ✓ Imputed Marginal Rates
- Most Important:
 - ✓ Tax Efficiency should Enhance (not replace)
Bond Analytics

The Importance of Communication



- Get Everyone on the Same Page
 - ✓ Goals of Consultants, Portfolio Manager, Management and Board must be aligned
- Education and Planning
 - ✓ Long-Term Economics vs. Short-Term Accounting Treatment
 - ✓ Budget for Losses

A Final Thought

Information

is Not

Knowledge

is Not

WISDOM

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Thank You

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Special thanks to :



Tax Smart Strategies

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For Additional Questions or Information:

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