



EK4T

EK4T Inner Circle

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ESSENTIAL KNOWLEDGE
FOR TRANSITION

TAXES and Investing Topics

- Tax on capital gains and investment income
- Tax advantaged vehicles
- Dealing with naughty appreciated stocks



TAXES ON CAPITAL GAINS AND INVESTMENT INCOME

Investment Proceeds

- If you are lucky some of your investments will return some money to you:
 - Distributions
 - Dividends
 - Interests / Principal
 - Proceeds from sale

Legal Form Dictates Tax Treatment

- C-corporation (e.g. publicly traded stock)
 - Issue 1099-DIV
- LLC
- Limited Partnership
 - LLC and LP issue K1
- Note
 - Issue 1099-INT 1099-B or 1099-OID

C - Corporation

- All publicly traded stocks are C-corp legal entities
 - The entity itself pays the taxes for the profits it generates
 - It might decide to distribute some of the profits as dividends
 - Dividends of stocks you own are treated as ordinary income for the purpose of taxation
 - When you sell the stock you might have a capital gain or loss

Taxation on Capital Gain/Loss

- Capital gains
 - Long term (0% 15% 20% depending on income)
 - Short term
- Capital loss
 - Can be used to offset other capital gains
 - \$3,000 can be used to offset regular income
 - Capital loss carry forward

LPs and LLCs

- LP stands for Limited Partnership
- LLC stands for Limited Liability Company
- LPs and LLCs are pass-through structures
 - Passive income (losses)
- Distributions:
 - Taxed at ordinary income rates
 - Taxed as capital gains
 - Not taxed (return of capital invested)

Notes and Royalties

- Royalties are tricky from a tax standpoint
- Interests
- Principal

Tax on Investment Proceeds

- Distributions (LP and LLC – via K1)
- Dividends (1099 – DIV)
- Interests / Principal (1099 INT,B,OID)
- Proceeds from sale (K1)



TAX-ADVANTAGED VEHICLES

Encouraging Saving

- US Government provides the carrot of reduced taxes to encourage saving
 - for retirement
 - for college tuition
 - for medical expenses

Tax-Advantaged Retirement Saving Vehicles

- 401K
- IRA
- Roth-IRA

401K

- Usually sponsored by employer
 - From defined benefits to defined contributions retirement plans
 - Employer matching
 - Investment choices limited by 401K platform (e.g. Fidelity, Schwab, Social 401k etc.)
- Solo 401K – for solopreneurs
 - Very attractive check-book control

Discount Solo 401K

- I am using Discount Solo 401K as my provider
- www.discountsolo401k.com
- Founder Justin Windham
- justin.windham@discountsolo401k.com

Individual Retirement Accounts

- Tradition IRA (pre-tax \$ in)
- Roth-IRA (after-tax \$ in)
- Self-Directed IRA
 - requires a SDIRA custodian
 - large flexibility in investing but SDIRA custodian might impose constraints
 - adds one layer of paperwork to investing
 - checkbook SDIRA

DEALING WITH NAUGHTY APPRECIATED STOCKS

SCENARIO

- You inherit a large position in evil XON from your father
- It makes up 30% of your portfolio
- Base cost is \$5 – market price is \$100

Only Two Ways to Avoid Capital Gain Taxes

- Die
- Donate
- Otherwise, sooner or later you will have to pay capital gains taxes

Strategy One

- Use your evil appreciated stock as your charity \$
- You can deduct your donation at current market value
- Non-profits can sell it without incurring capital gains taxes
- Impact Assets DAF – and use them for the return agnostic portion of portfolio

Strategy Two

- Avoid benefitting from shenanigans of evil stock
- Sell at-the-money call options on XON
 - If XON drops in price use windfall to offset capital gains of selling more XON
 - If XON prices goes up use the loss from the options to offset capital gains from sale of XON

Strategy Three – Bite the Bullet

- Determine a yearly budget for capital gains taxes
- Use it to unload gradually evil stocks
- Remember, unless you die or donate, sooner or later you will have to pay capital gains taxes!

Useful Links

- <https://www.nerdwallet.com/blog/taxes/capital-gains-tax-rates/>
- <https://thismatter.com/money/funds/dpp/limited-partnership-taxation.htm>