

Kathleen M. Fisher
Head—Wealth Management Group

Tara Thompson Popernik
Director of Research—
Wealth Management Group

Paul L. Robertson
Senior Portfolio Manager



My, What Big Teeth You Have!

Reducing This Year's Tax Bite

Some Americans will be shocked when they see their income-tax bills for 2013. For the couple whose federal income taxes are summarized below, this year's tax bill will be 14% higher than last year's (*Display 1*).

Display 1

Sizing Up the Bite

Federal Tax Differences: 2013 vs. 2012

Income for a Hypothetical Client

Salary: \$300,000 Rental Income: \$100,000 Long-Term Capital Gains: \$150,000

Payroll Taxes

	2012	2013	Increase
Social Security	\$4,624	\$7,049	\$2,425
Medicare	4,350	4,350	—
Hospital Insurance Tax	N/A	450	450

Income Taxes

Ordinary Income	\$102,472	\$104,287	\$1,815
Long-Term Capital Gains	22,500	26,890	4,390
Tax on Net Investment Income	N/A	9,500	9,500
Totals	\$133,946	\$152,526	\$18,580

Recent changes in the tax code may make strategies for managing taxes especially valuable this year. In this paper, we address:

Reducing your tax bill.....	Page 2
Harvesting portfolio losses	Page 2
Taking additional capital gains	Page 3
Contributing to retirement plans	Page 4
Delaying the recognition of income.....	Page 4
Obtaining a charitable deduction	Page 5
Making gifts to family and friends.....	Page 6
Saving on taxes with a 529 Plan	Page 7
Converting to a Roth IRA	Page 7
Understanding new tax rules for married same-sex couples	Page 8
Raising cash to pay taxes.....	Page 8

Hypothetical clients, assumed married filing jointly with one salary earner. For this illustration, the alternative minimum tax (AMT) has been ignored. In this simplified example, taxable income is calculated as adjusted gross income less the standard deduction (\$11,900 in 2012; \$12,200 in 2013) and personal exemption (\$7,600 in 2012; phased out for joint filers with adjusted gross income above \$300,000 in 2013). Ordinary income is considered part of taxable income before other income items, such as capital gains, for applying tax thresholds and deductions. The hypothetical clients' taxable income in 2012 is \$530,500, consisting of \$380,500 in salary and rental income, and \$150,000 in long-term capital gains; in 2013 the taxable income is \$537,800, consisting of \$387,800 in salary and rental income, and \$150,000 in long-term capital gains. Taxes and rates are calculated as follows: Social Security: 4.2% on \$110,100 of salary income in 2012 and 6.2% on \$113,700 of salary income in 2013; Medicare: 1.45% on salary income (same for 2012 and 2013); Medicare hospital insurance tax (new tax in 2013): 0.9% on salary income above \$250,000; ordinary income: 33% marginal tax bracket (same for 2012 and 2013 in this case); long-term capital gains: 15% in 2012; in 2013, 15% on the capital-gains portion of taxable income under \$450,000 and 20% on the capital-gains portion of taxable income above \$450,000; Medicare tax on net investment income (new tax in 2013): for joint filers, 3.8% on net investment income (includes rental income and capital gains) that exceeds a modified adjusted-gross-income threshold of \$250,000.

Source: Tax Foundation and AllianceBernstein

The American Taxpayer Relief Act of 2012 (ATRA) introduced a new top marginal rate of 39.6% for ordinary income. Combined with the 3.8% Medicare surtax imposed by the Affordable Care Act of 2010, this results in a top federal rate of 43.4% for some types of investment income—taxable interest, non-qualified dividends, and short-term capital gains. At the same time, the top federal rate for long-term capital gains and qualified dividends went from 15% to 23.8%.

Most tax-management steps require deliberate decisions on your part, but some, such as tax-loss harvesting, are strategies that Bernstein can apply to your portfolio in the normal course of managing your account. Note that Bernstein does not provide tax or legal advice. Before you take any action, we urge you to confer with your tax advisor to determine what measures would be appropriate in your specific tax situation. This is particularly relevant to state taxes, since some state provisions do not conform to federal tax law.

How can I reduce my income-tax bill in 2013 and beyond?

Some taxes can be deferred to future years, some can be permanently avoided, and some strategies can do both, although there may be costs.

You can defer paying income taxes by:

- Harvesting portfolio losses to offset capital gains;

- Increasing your contributions to retirement vehicles such as 401(k), IRA, and Keogh plans;

- Delaying the recognition of income.

You can avoid income taxes by:

- Making a charitable donation;
- Contributing to a 529 plan;
- Timing trades so that gains will be long-term and dividends will be qualified;
- Holding appreciated assets until death; the resulting step-up in cost basis will relieve your beneficiaries of tax on capital gains that occurred during your lifetime;
- For certain investors with a long time horizon, converting a traditional IRA to a Roth IRA (pay taxes now to avoid taxes later).

Below, we address some of the key questions we're being asked about these tax-saving principles.

Deferring Taxes

How can portfolio losses be harvested to offset capital gains?

Investors subject to this year's higher capital-gains tax rate can potentially benefit more from tax-loss harvesting.

To harvest a loss, we sell a security that has fallen below the price we paid for it, but that we believe still has appreciation potential. For tax purposes, the realized loss offsets a gain we've booked elsewhere in the portfolio. After waiting 31 days (because of the wash-sale rule), we

can buy back the same security, or without waiting, we can buy a different security.

Note that loss harvesting, whether in a bond or stock portfolio, does not eliminate gains; rather, it defers their realization (perhaps, but *not necessarily*, to a time when your tax rate may be lower). That's because selling an asset at a loss today and reinvesting the proceeds reduces the cost basis of your portfolio. When, at some future date, you sell securities bought with the proceeds, the capital gain will be that much larger, assuming appreciation.

Let's suppose, for example, that you've sold Stock A at a gain of \$50, and want to offset that gain. Let's further assume you're holding Stock B, with a cost basis of \$100 and a current value of only \$50. You still see return potential from Stock B but also want to use it to offset the gain on Stock A. If you sell B to offset the \$50 gain on A, you can then use the proceeds to repurchase B 31 days later. When you sell B, your future capital gain will be higher by the same amount that your capital gain on A was reduced (*Display 2, next page*). Ultimately, the taxman is likely to be paid.

It's true that delaying the tax bill should allow some additional growth in your portfolio—but losses must be fairly large to make loss harvesting worthwhile. If you have a combined federal and state capital-gains tax rate of 25%, applying the \$50 loss on Stock B to the \$50 gain on Stock A

Bernstein does not offer tax, legal, or accounting advice. In considering this material, you should discuss your individual circumstances with professionals in those areas before making any decisions.

Display 2

Loss Harvesting *Defers*—but Does Not Avoid—Taxes

Harvesting a \$50 Loss and Repurchasing the Stock*

Combined federal and state long-term capital-gains tax rate of 25%

Stock A: Recognized Gain	This Year (\$)	Next Year (\$)
Existing gain	50	—
Potential long-term capital-gains tax	12.50	—
Stock B: Harvested Loss		
Cost basis	100	50
Sale price	50	100
Repurchase price (new cost basis)	50	—
Long-term gain (loss)	(50)	50
Tax deferred	12.50	0
Tax paid	0	12.50

*Data are for illustrative purposes only and use round numbers to demonstrate how cost basis changes when losses are harvested. There is no expectation that a typical stock would double in price over one year.
Source: AllianceBernstein

lets you keep \$12.50 in the portfolio that would otherwise have been withdrawn to pay taxes. If you can hold this money in the portfolio for more than a year and earn 10% on it, you will have a \$1.25 return. Since you will have to pay taxes on this return (again, at 25%), your after-tax return will be \$0.94. In other words, you will have sold and repurchased a stock worth \$50 (for a total trade value of \$100) to earn a mere 94 cents. The transaction costs must also be taken into account. While Bernstein imposes no transaction fees, there are costs related to differences between purchase and sales prices (bid/ask spreads). In this case, if the transaction costs are greater than 1% (or \$1), the trade won't add value; it will erode it.

These details matter. At Bernstein, we selectively harvest losses in clients' stock portfolios, screening all holdings by tax lot. For one thing, as we said, the size of the loss counts. The minimum loss that we will consider harvesting varies from year to year. When the applicable tax rates or projected future asset-class returns are relatively high, we can profitably harvest smaller losses. When the transaction costs are high, losses have to be larger to be harvested profitably. This is also true when estimated portfolio turnover is relatively high, since shorter holding periods allow less time to earn a return on money being kept in the portfolio rather than paid out in taxes.

A Question About Capital Gains

Alabama, New Jersey, and Pennsylvania don't allow capital-loss carryforwards. Should taxpayers in those states take additional capital gains this year to fully offset their realized capital losses?

Probably not. Although doing so could potentially lower your state tax in future years without affecting your federal tax, there's a problem with this strategy: You'll have to pay the transaction costs up front, but you won't reap the benefit until some unspecified time in the future.

The further into the future you go, the less likely it is that the benefit of lower state taxes will overcome your transaction costs. We think that a better way to manage your account is to not incur additional transaction costs with trades motivated only by tax considerations. Rather, we'd continue to trade the portfolio with the aim of maximizing returns but change our approach to tax-lot selection by selling lots that emphasize gains (generally favoring those lots with the lowest cost bases).

We continuously apply a similar process to harvest losses within bond portfolios as well, but need to consider market liquidity and the availability of attractively priced replacement bonds. Assuming that we can find attractive alternatives, we'll be actively looking to harvest losses in our bond portfolios for the remainder of this year.

How much can I contribute to my retirement plans?

Contributions to your retirement plan directly reduce your adjusted gross income (AGI) and, hence, your taxable income. By taking full advantage of your traditional qualified plans, you can not only reduce this year's income-tax burden, but also keep more of your assets in your investment portfolio, where they can compound tax-free until they're withdrawn.

If you have earned income in 2013 and are younger than 50, you can contribute up to \$17,500 to a 401(k), 403(b) or 457 plan. If you are 50 or older, you can make an additional \$5,500 catch-up contribution, for a total of \$23,000. If you have a traditional individual retirement account (IRA), you can contribute up to \$5,500, and if you're 50 or older, you can make a catch-up contribution of \$1,000, for a total of \$6,500.

Further, married couples may not be aware of an opportunity to increase their contributions: A working spouse can make a full contribution to an IRA on behalf of a nonworking spouse.

If you're self-employed or own a very small business, you can contribute up to \$51,000 yearly (including employer and employee contributions) to a Simplified Employee Pension IRA (SEP IRA) or a Keogh plan. Business owners can also reduce company profits, and thus taxes, by increasing company contributions to defined-contribution plans and defined-benefit plans.

And note that for some professionals and business owners, another

attractive option may be available: a cash balance plan. Professionals who want to shelter additional current income from taxes may be able to contribute up to \$214,000 more per year to a cash balance plan—a vehicle that has features of both a defined-benefit and a defined-contribution plan. Contact your Bernstein Advisor if you are interested in learning more.

How can I delay the recognition of income?

If you believe that this year you'll be on the borderline between two tax brackets, you may be able to keep yourself in the lower one by delaying certain income items until 2014. There are several techniques that are often valuable, although (by definition) they do reduce the income that you will have available this year to spend or reinvest:

Managing stock options

Non-qualified grants of company stock options are taxable at ordinary income rates when exercised, so deferring exercise of significantly "in-the-money" options defers recognition of the income. But taxes are not the only consideration. For example, if for any reason the company stock seems vulnerable to decline, you may be better off exercising now, selling the underlying shares, and paying the additional tax.

Tax management of incentive stock options (ISOs) is more complex. Under the regular income-tax rules, you don't pay tax for exercising ISOs, but you pay capital-gains tax when you sell the underlying stock. If you

wait to sell the stock until more than one year has passed after the option was exercised and more than two years after the option was granted, the gain will be long-term. However, the spread between the grant price and the exercise price is taxable under the alternative minimum tax (AMT) rules, and this item could be large enough to put you into the AMT. For this reason, it's wise to consult with your tax advisor before deciding how and when to exercise ISOs.

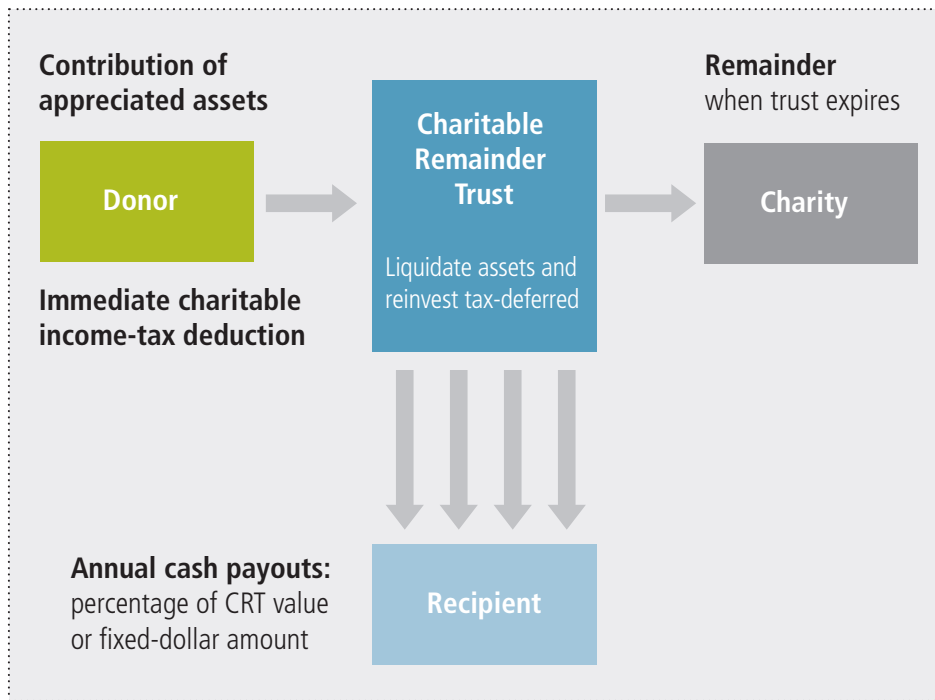
Reducing the size of a concentrated position

Selling down a large position in a single stock could be a very good way to reduce the overall risk in your portfolio, but if the stock has appreciated, the capital gain might be large enough to push you above a key tax threshold—for example, the threshold for paying the Medicare surtax on net investment income. Rather than divesting the entire position at once, you might want to consider spreading the sale out over several years.

Given this year's increase in the top capital-gains tax rate, you might also want to consider a more tax-efficient strategy for reducing any single-stock exposure you may have. A charitable remainder trust (CRT) could be a good solution. CRTs are designed to support charity while also generating income for the donor. The structure is straightforward: You make an irrevocable contribution of assets to a trust that subsequently distributes payouts to you or another designated recipient for life or a term of years. You receive a charitable tax deduction

Display 3

How a Charitable Remainder Trust Avoids and Defers Taxes



Source: AllianceBernstein

for the portion of the contribution equal to the charity's "share" of the trust, according to an IRS formula. At the end of the trust term, the assets remaining in the trust pass to charity.

If you contribute your appreciated stock position (*Display 3*), the trust will typically sell it and reinvest the proceeds in a diversified portfolio. The trust does not pay tax on the capital gain at the time of sale, so the full appreciated value remains in the portfolio to compound over time. As you receive payouts from the CRT, under the tiered rules of accounting you'll eventually be taxed on the gain—but deferral of this tax can have favorable financial consequences.

In sum, with a CRT you can avoid taxes, via the charitable deduction, and also defer any gains tax on the contributed assets until annual cash payouts are received.

Avoiding Taxes

How can I best obtain a charitable deduction?

Charitable giving remains one of the few ways you can avoid taxes outright. While the new ATRA rules have reinstated a limit on itemized deductions for high-income taxpayers,¹ the increase in the top tax bracket has also made charitable deductions more valuable.

A gift of cash to a public charity can offset as much as 50% of your AGI for the year in which the gift is made, and gifts of appreciated assets can offset up to 30% of your AGI. Any charitable deduction that surpasses this year's AGI threshold can be carried forward for up to five additional years. In most cases, you will be better off donating appreciated securities rather than writing a check. If you've held the securities for more than a year, you'll receive a charitable income-tax deduction for the current value of the securities *and* avoid paying tax on the capital gain. Even private foundations can benefit from making grants with appreciated securities rather than with cash because they won't face the 1%–2% excise tax on appreciation that would otherwise be due if the securities were sold inside the foundation.

You generally won't want to donate appreciated stock held for less than one year because the deduction will be equal to the cost basis, not the current value. On the other hand, if the current value of the securities is below the purchase price, it is usually better to sell them and donate the proceeds. This way, you can realize a loss and use it to offset gains elsewhere.

If you will have unusually high income or gains in 2013, you may want to accelerate your charitable gifts over the next few years by funding a donor-advised fund or private

¹For individuals with AGI above \$250,000 and couples with AGI over \$300,000 (indexed for inflation), deductions are limited by the lesser of: i) 3% of the amount in excess of the AGI thresholds; or ii) 80% of the deductions claimed. AGI is total gross income minus certain business expenses and other specific items.

foundation—vehicles that permit you to receive the full charitable income-tax deduction this year while waiting to designate the charitable beneficiaries in years to come. Note that different rules govern deductions for gifts to donor-advised funds and to private foundations. Donor-advised funds are considered public charities; thus, cash gifts are generally deductible up to 50% of AGI and stock gifts up to 30% of AGI. By contrast, cash gifts to private foundations are deductible up to 30% of AGI and stock gifts up to 20% of AGI.

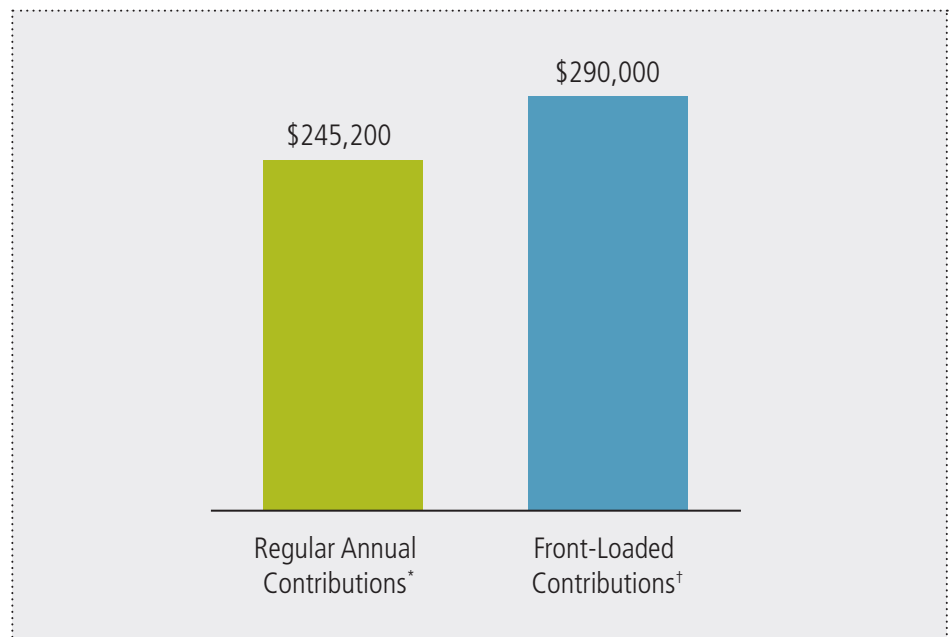
Last, if you are an IRA owner over the age of 70½, you have another charitable-giving alternative to consider: Until December 31, 2013, you can contribute up to \$100,000 from your IRA to charity. This direct rollover, which will not result in any tax or tax deduction, will qualify as part of your required minimum distribution (RMD) for the year if you need to take it but have not already done so. Because the distribution is excluded from gross income, the gift may reduce your income enough to bring you below one of the tax thresholds. Still, donating appreciated securities from your taxable portfolio may be preferable. We can help you evaluate the trade-offs.

Should I make gifts to family and friends before year-end?

If you have wealth beyond your core-capital needs—which we define as the amount needed to sustain your lifetime spending goals, even in hostile markets—and would like to transfer money to family members or others,

Display 4

Funding a 529 Plan Early Results in More Savings 529 Plan Assets After 15 Years (Median Case)



*\$28,000 a year for six years

†\$28,000 this year and \$140,000 next year

We assume that the 529 assets are invested in 100% globally diversified equities when the child is age 2. The 529 allocation becomes more oriented toward bonds over time, until it reaches 25% globally diversified equities and 75% fixed income at the child's college age. Based on Bernstein's estimates of the range of returns for the applicable capital markets over the next 15 years. Data do not represent past performance and are not a promise of actual future results. See Notes on Wealth Forecasting System at the end of this paper for further details.

Source: AllianceBernstein

the current annual gift-tax exclusion is \$14,000 per person (\$28,000 per couple). If you wish to transfer a substantial amount of wealth, short-term rolling grantor-retained annuity trusts (GRATs) are an effective vehicle for transferring the appreciation of assets in a tax-free manner and may be appropriate in the context of a comprehensive estate plan.

Low interest rates make many wealth-transfer strategies particularly attractive today. The success of these strategies is based on IRS-determined hurdle rates, calculated from US Treasury interest rates. Although these hurdles have crept up recently,

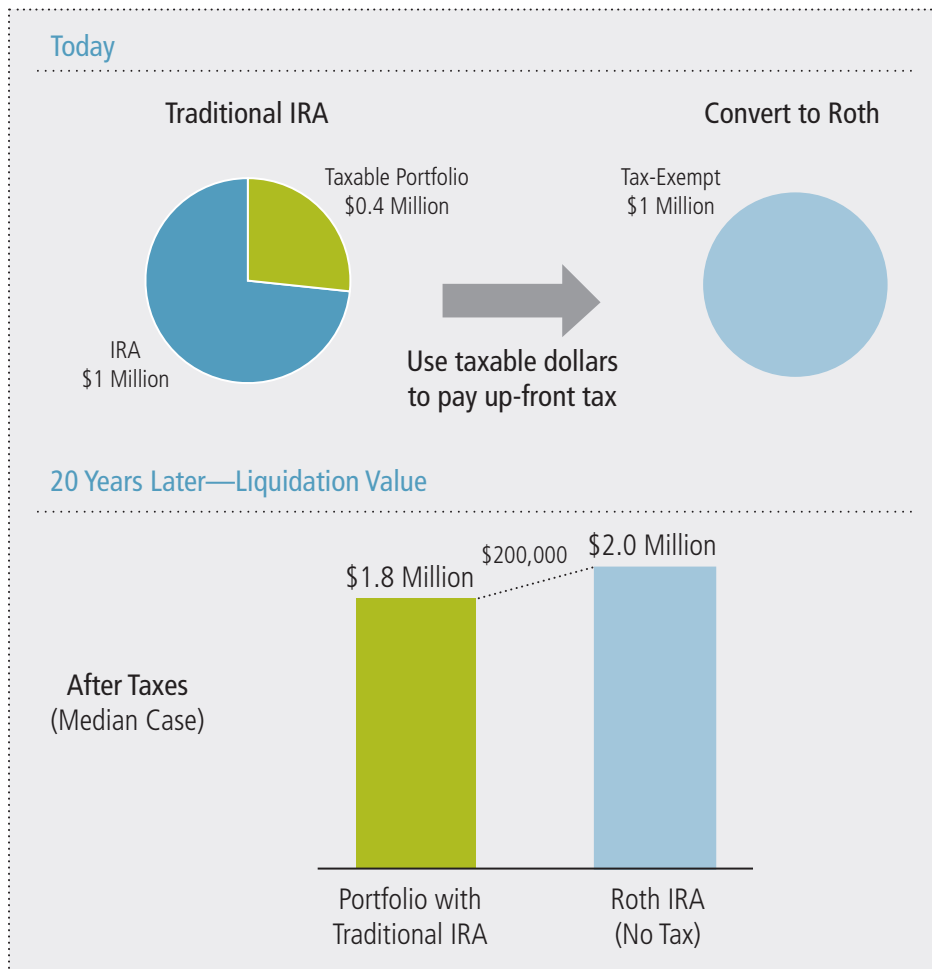
they remain near historical lows. Under these conditions, long-term GRATs, charitable lead trusts (CLTs), intra-family loans, and installment sales to intentionally defective grantor trusts (IDGTs) can be especially effective.

In the case of GRATs and CLTs, the relevant hurdle is called the Section 7520 rate. Since its introduction in the late 1980s, the 7520 rate has averaged approximately 5.9%. The all-time low, most recently reached in January 2013, is 1.0%, and the September 2013 rate is 2.0%. If you're considering any of the above strategies, you may want to act quickly to take advantage of a favorable rate.

Display 5

Converting to a Roth: The Advantage of Tax-Free Growth

Outcome per \$1 Million IRA, Inflation-Adjusted*



*The initial account values for an investor age 65 taking required minimum distributions at 70½; tax on converting a \$1 million traditional IRA to a Roth IRA would total \$435,200. Assumes any traditional IRA assets remaining after 20 years are liquidated, resulting in a tax liability of 39.6% federal and 6.5% state on ordinary income, and 23.8% federal and 6.5% state on long-term capital gains (includes Medicare surtax on net investment income). All assets are assumed to be invested in 60% globally diversified equities and 40% intermediate-term fixed income. Based on Bernstein's estimates of the range of returns for the applicable capital markets over the next 20 years. Data do not represent past performance and are not a promise of actual future results. See Notes on Wealth Forecasting System at the end of this paper for further details.
Source: AllianceBernstein

Would a 529 Plan help me save on taxes?

If you expect to pay for college in the future, this could be a way to avoid future taxes on portfolio growth.

You can contribute up to five years' worth of annual exclusion gifts to a 529 college savings plan (\$70,000 per person or \$140,000 per couple) for

the benefit of a child, a grandchild, or anyone else. Assets inside the plan grow tax-free and will not be subject to income taxes if used for qualified educational purposes.

Front-loading the plan with an additional contribution can really help jump-start savings (*Display 4, previous*

page). Let's say that a couple opts to accelerate giving for a two-year-old child—contributing \$28,000 in 2013 and \$140,000 at the beginning of 2014 (waiting to front-load the contribution to the beginning of the next tax year in order to promote growth)—versus making an annual contribution of \$28,000 in 2013 and \$28,000 per year for the next five years. In our hypothetical model, the money is invested in an age-based asset-allocation fund that starts out allocated 100% to equities and gradually becomes more conservative over time.

The result of front-loading: The difference in growth by the time the child is looking at colleges is almost \$45,000 in median markets, adjusted for inflation—probably enough to cover a full year of tuition at a private college and, at some institutions, room and board charges, too.

Should I convert my traditional IRA to a Roth IRA?

Conversions to Roth IRAs are available to all investors, with no income limitations. You'll face a larger tax bill this year, but you'll free yourself from having to take RMDs by age 70½. Avoiding distributions could help you stay below tax thresholds in the future. In addition, with a Roth IRA you pay taxes on your contributions up front. If you convert and pay the taxes from outside the IRA, more of your wealth will then grow in a tax-free (even better than a tax-deferred) environment. That's the great benefit of conversion (*Display 5*).

You may feel that you missed the boat by not converting your IRA to a Roth last year, when tax rates were lower. However, our research shows that conversion may be beneficial over long time horizons, even at today's higher rates. Consider the case of a 65-year-old investor who has \$1 million in a traditional IRA and personal investments of \$435,200 to cover the tax cost of the conversion. We also assume that the assets won't be spent for 20 years, so they can keep on growing. At the 20-year point, we assume that all accounts will be liquidated and taxes paid, so we can compare pretax and after-tax dollars on a level playing field.

We estimate that in this case the after-tax advantage of the Roth over the traditional IRA would be about \$200,000 in today's dollars. If the investor planned to leave the assets to his children, they would inherit a far larger Roth IRA, which would never be taxed and could grow for additional decades.²

We don't mean to suggest that a Roth conversion is right for everyone. Investors who expect to spend down their IRAs or to pay a lower effective tax rate in the future should likely avoid conversion. It's important to note that our analysis relies on the assumption that tax rules don't change over the 20-year horizon. Future rule changes (for example, limiting the benefit of a "stretch" to younger generations) could erode the

long-term value of a conversion done today.

Also, there may be better ways of timing the conversion so that taxes are not all recognized in one year: You could convert part of a traditional IRA in 2013 and another part in 2014 to spread out and potentially lower the tax bite. Thinking through the timing can be especially valuable if you are on the cusp of retirement and may have a much lower effective tax rate in the near future. Bernstein will work with your tax professionals to determine if a Roth conversion would be right for you and, if so, advise on the best way to execute it.

Other Tax Issues in 2013

How have federal tax rules changed for married same-sex couples?

This year, married same-sex couples will, for the first time, file federal tax returns jointly or as married filing separately. If they're living in a state that recognizes their marriage, they will base their state tax returns directly on their federal returns. If you are in a same-sex marriage, you may wish to refile income-tax returns for previous years if this will result in a refund. The IRS has just given some guidance on this issue (see Revenue Ruling 2013-17), but you should discuss your situation with your tax professional.

As far as transfer taxes go, any past gift-tax returns filed for transfers to a spouse that required you to use your applicable exclusion amount should be

revisited and potentially refiled now so that you can preserve your applicable exclusion for other uses. If the gift was made to a trust that can't qualify for the marital deduction, there may be an opportunity to rescind the gift. Be sure to engage your professional in reviewing your estate plans.

Finally, to ensure that your Bernstein account is managed appropriately, please let your Advisor know about any revisions in your estate plan so that your account information can be brought up to date.

How can I best raise cash to pay taxes?

When raising cash for our clients, we focus on maintaining portfolio integrity and tax efficiency. We start by trimming asset classes where your holdings exceed your strategic-allocation target and continue until we've restored your holdings to their targeted weights. Whether the assets are mutual funds or individual securities, we try to sell units or lots with the lowest tax cost. If we've brought all your holdings to their targeted weights but need to raise more cash, we start selling assets roughly proportionately across your portfolio. However, we exempt from this process investments with large tax costs, such as securities with big embedded short-term gains that are about to become long-term.

A key consideration is whether you also expect to raise cash from the portfolio in future years. Imagine

²When a Roth IRA is stretched in this way, the beneficiaries are obliged to take RMDs over time, which will be free of income tax. However, the IRA may be subject to estate tax before it passes to the younger generation.

Display 6

Selling Assets to Raise Cash

Minimizing the Tax Levy*

Tax Facts:		Lot A	Lot B
Purchase Date		January 2, 2013	January 2, 2009
Current Value		\$100	\$100
Cost Basis		\$80	\$30
Type of Gain		Short in 2013 Long in 2014	Long

Sell in 2013 Only		Lot A	Lot B
Question: Sell A or B?			
Tax Cost		\$8.68 (\$20 × 43.4%)	\$16.66 (\$70 × 23.8%)
Strategy: Sell Lot A			

Sell in 2013 and 2014				
Question: Sell A or B First?				
Tax Cost				
Sell A in 2013, B in 2014	\$8.68	+	\$16.66	= \$25.34
Sell B in 2013, A in 2014	\$4.76 (\$20 × 23.8%)	+	\$16.66	= \$21.42
Strategy: Sell Lot B First				

*Assumes that long-term capital gains are taxed at 23.8% and short-term gains at 43.4%. Data are illustrative and assume that the stock in question remains constant in price in 2013 and 2014. Source: AllianceBernstein

an investor who needs to raise cash from her taxable assets this year and is deciding between two lots of a security with a market value of \$100. Lot A is short term in 2013, with a cost basis of \$80. Lot B, purchased some time earlier, has a cost basis of \$30. Lot A would have a tax cost of \$8.68 (\$20 × 43.4%) if sold, and Lot B would have a tax cost of \$16.66 (\$70 × 23.8%—Display 6). If she won't need to do this again next year, we could sell Lot A (in this instance,

selling at a short-term gain makes sense, since Lot A's cost basis is so much higher than Lot B's). But if she's going to sell stock next year, too, we could hold Lot A and sell it at a long-term gain next year. If the stock price does not change, that tax cost would be \$4.76 (\$20 × 23.8%).

If we sell Lot A this year and Lot B next year, she might pay \$25.34 (\$8.68 + \$16.66). If, instead, we sell the long-term lot this year and wait

until next year to sell the lot that is currently short-term, she might pay the lower amount of \$21.42 (\$16.66 + \$4.76). Obviously, stock prices don't stay constant over the course of a year, but this analysis highlights why our decisions about which lots to sell incorporate an estimate of how frequently a client is likely to raise cash.

Conclusion

Given the recent rise in tax rates, you may be asking the questions above with a renewed sense of urgency. Some of the answers we've suggested (such as contributions to retirement accounts) can make a sizable difference in your current tax bill, while others, such as harvesting capital losses, provide incremental benefits that can compound in your portfolio over time. All these strategies can help protect your wealth against a very large tax bite in 2013 and, as a result, can help advance you toward meeting your financial goals. ■

Notes on Wealth Forecasting System

The Bernstein Wealth Forecasting SystemSM (WFS) is designed to assist investors in making a range of key decisions, including setting their long-term allocation of financial assets. The WFS consists of a four-step process: (1) Client Profile Input: the client's asset allocation, income, expenses, cash withdrawals, tax rate, risk-tolerance goals, and other factors; (2) Client Scenarios: in effect, questions the client would like our guidance on, which may touch on issues such as which vehicles are best for intergenerational and philanthropic giving, what his/her cash-flow stream is likely to be, whether his/her portfolio can beat inflation long term, when to retire, and how different asset allocations might impact his/her long-term security; (3) The Capital Markets Engine: our proprietary model that uses our research and historical data to create a vast range of market returns, taking into account the linkages within and among the capital markets (not Bernstein portfolios), as well as their unpredictability; and (4) A Probability Distribution of Outcomes: based on the assets invested pursuant to the stated asset allocation, 90% of the estimated returns and asset values the client could expect to experience, represented within a range established by the 5th and 95th percentiles of probability. However, outcomes outside this range are expected to occur 10% of the time; thus, the range does not establish the boundaries for all outcomes. Further, we often focus on the 10th, 50th, and 90th percentiles to represent the upside, median, and downside cases.

Asset-class projections used in this paper reflect initial market conditions as of June 30, 2013. They include the following median forecasts of 20-year compound rates of return: US diversified stocks (represented by the S&P 500 Index), 7.3%; US value stocks (represented by the S&P/Barra Value Index), 7.5%; US growth stocks (represented by the S&P/Barra Growth Index), 7.0%; small-/mid-cap stocks (represented by the Russell 2500 Index), 7.5%; developed international stocks (represented by the Morgan Stanley Capital International [MSCI] EAFE Index of major markets in Europe, Australasia and the Far East, with countries weighted by market capitalization and currency positions unhedged), 8.1%; emerging-market stocks (represented by the MSCI Emerging Markets Index), 6.3%; taxable bonds (represented by investment-grade bonds of 7-year maturity), 3.2%; and inflation (represented by the Consumer Price Index), 2.5%. Globally diversified equity modeled as 21% US diversified, 21% US value, 21% US growth, 7% small-/mid-cap, 22.5% developed international, and 7.5% emerging markets.

An important assumption is that stocks will, over time, outperform long-term bonds by a reasonable amount, although this is by no means a certainty. Moreover, actual future results may not be consonant with Bernstein's estimates of the range of market returns, as these returns are subject to a variety of economic, market, and other variables. **Accordingly, this analysis should not be construed as a promise of actual future results, the actual range of future results, or the actual probability that these results will be realized.**

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Our Best Thinking	Centrally Managed Investments To give you direct access to our best thinking, we've structured our business around centralized research and investment management, with integrated wealth planning.
Customized Portfolios	Attention to Your Details Your particular circumstances guide the way we manage your money, as we tailor portfolios to your goals, income needs, tax situation, and tolerance for risk.
Tax-Aware Investing	Keeping More of What You Earn To help you keep more of what your investments earn, we employ tax management strategies in multiple ways.
Keeping You Informed	Communication Works Both Ways When you're well-informed about the strategies we pursue, you're more secure. And the more we understand you, the better we can tailor solutions just for you.
A Legacy of Trust	Commitment to Individuals, Families, and Their Causes When you entrust Bernstein to serve as your investment manager, you become part of a proud tradition of integrity, trust, and financial success.

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