Asset location: same portfolio, more wealth after tax

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The idea

Two families can hold exactly the same investments and still end up with substantially different after-tax wealth, as a consequence of which type of account each investment sits in. Deciding that placement is called asset location.

Asset allocation decides what to own. Asset location decides where to hold it, across taxable accounts, tax-deferred accounts such as traditional IRAs and 401(k)s, and tax-free Roth accounts. It changes nothing about the portfolio's risk, only how much of its return is lost to tax along the way.

Vanguard's simulations suggest good asset location can add up to about 0.3% a year after tax for a well-diversified investor with money in both taxable and tax-advantaged accounts.[1] That is modest in any one year, but it compounds, and it comes without taking more risk.

The three kinds of account

Each kind of account taxes the same return differently.

Account	Examples	Income and gains each year	Withdrawals
Taxable	Individual, joint and most trust accounts	Interest and dividends taxed when paid; gains taxed when sold	Not taxed again
Tax-deferred	Traditional IRA, traditional 401(k)	Not taxed	Taxed as ordinary income, whatever the source
Tax-free	Roth IRA, Roth 401(k)	Not taxed	Generally not taxed, once the rules are met

In a taxable account, how a return is earned matters a great deal. For a high earner in 2026, interest is taxed at up to 37%, while qualified dividends and long-term gains are taxed at up to 20%; both can carry a further 3.8% net investment income tax.[2] State taxes come on top. California, for example, taxes all of these as ordinary income at up to 13.3%, so a top-bracket Californian can pay about 54% on interest and 37% on long-term gains.[3] Gains are also taxed only when the investor chooses to sell.

Inside a tax-deferred account those differences disappear: everything comes out as ordinary income. Inside a Roth account, nothing is taxed at all.

Why location matters

Assets that produce income taxed at high rates each year lose the most in a taxable account. Assets whose return comes mostly from price growth lose the least, because the tax is lower and can be put off.

Consider a family with $6 million: $3 million in a taxable account and $3 million in a traditional IRA, invested half in stocks and half in bonds. Assume bonds yield 4.5%, stocks pay a 1.5% dividend, and the family is a top-bracket California household paying the combined rates above.

Placement	Held in the taxable account	Tax paid each year in the taxable account
Bonds in taxable, stocks in the IRA	$3 million of bonds	About $73,000
Stocks in taxable, bonds in the IRA	$3 million of stocks	About $16,700

The same portfolio pays about $56,300 a year less tax along the way, simply by swapping which account holds which asset. The stocks' growth in the taxable account is not taxed until sold, and may never be.

This shows only the tax paid each year. Money in the IRA is taxed as ordinary income when withdrawn, and stocks held there lose their lower capital-gains rate, so the full lifetime benefit is smaller than the annual difference suggests. That is why careful studies put the benefit at a fraction of a percent a year rather than the 0.9% this simple comparison implies.

How it is done in practice

The usual starting point is to place the least tax-efficient assets in tax-advantaged accounts and the most tax-efficient in taxable accounts, then adjust for each family's situation.

Asset	Usual home	Why
Taxable bonds, high-yield credit, REITs	Tax-deferred	Income taxed each year at ordinary rates
High-turnover or active strategies	Tax-deferred or Roth	Frequent short-term gains
Assets with the highest expected long-term growth	Roth	Growth is never taxed
Broad stock index funds, tax-managed equity	Taxable	Low dividends, gains deferred until sold
Municipal bonds	Taxable	Already tax-exempt; wasted in an IRA
International stock funds	Often taxable	Foreign tax credit is usable only in a taxable account

Several considerations can override the starting point:

- **Assets meant for heirs or charity.** Holdings that may be given to charity or left to heirs, where gains may never be taxed, are usually best kept in taxable accounts.

- **Cash that may be needed.** Money a family may need before retirement belongs where it can be reached without penalties.
- **Room for tax-loss harvesting.** More volatile assets in a taxable account create more chances to realize losses that offset gains elsewhere.
- **Account sizes.** If tax-advantaged accounts are small, they fill up quickly with the least efficient assets, and the rest has to sit in taxable accounts regardless.

Beyond the basics

The placement rules above are where most advice stops. In practice, getting asset location right also means accounting for the tax still owed inside each account, and fitting placement around the strategies and decisions a family is already making.

- **Not every dollar is worth the same.** A dollar in a traditional IRA still carries the tax that will be paid when it is withdrawn; a dollar in a Roth account does not. In the example above, the $3 million of bonds in the IRA is worth about $1.8 million after a 40% tax on withdrawal. The taxable account owes tax only on its unrealized gains, and possibly never. Measured after tax, a portfolio that looks 50% stocks is closer to 60%. Measuring the allocation on an after-tax basis shows how much risk a family actually holds.
- **Location for specialized strategies.** Strategies that produce mostly short-term gains, such as many systematic strategies, are usually better held in tax-deferred accounts. Others are designed for taxable accounts: a tax-aware long/short portfolio is rebalanced with after-tax results in mind, index futures are taxed 60% as long-term gains, and box-spread financing produces capital losses that only a taxable account can use. Where each strategy sits is part of its design.
- **Roth conversions.** Converting part of a traditional IRA to a Roth account is a location decision too. Holdings can be moved across as they are, with income tax due on their value at the time. Converting in lower-income years, after a market fall when values are lower, or converting assets valued at a discount, such as interests in private funds, reduces that tax. Holding the highest-growth assets in the Roth account afterwards keeps their future growth out of tax.
- **Location changes over time.** Contributions, withdrawals, gifts, conversions and changes in tax law all shift what belongs where. Placement is reviewed as these happen, not set once.

Limits and cautions

Asset location helps only when it serves the overall plan; it should never change how much risk a family takes.

- **Allocation comes first.** The mix of stocks, bonds and other assets matters far more than where each is held. Location is decided after the allocation, never instead of it.
- **The household is one portfolio.** Once assets are placed by account, each account on its own looks lopsided. Risk, rebalancing and reporting have to be managed across all accounts together.

- **Rebalancing is harder.** After a sharp market move, restoring the target mix may mean trading inside the tax-advantaged accounts, where there is no tax cost, rather than selling in the taxable account.
- **Tax law and circumstances change.** Rates, brackets and the rules on retirement accounts change over time, as do a family's income, state of residence and plans. The placement should be reviewed as they do.
- **Withdrawals and estate plans.** Required minimum distributions from tax-deferred accounts, Roth conversions, charitable gifts and the step-up in basis at death all affect which account should hold what, and are best planned together.

IMPORTANT INFORMATION

This note is provided for general information and education. It is not investment, tax or legal advice, and it is not an offer to sell or a solicitation of an offer to buy any security or to engage any advisory service.

The example is a simplified illustration using assumed yields and tax rates; it is not a forecast and does not represent any actual portfolio. Tax treatment depends on each investor's circumstances and on tax law, which can change; investors should consult their own tax adviser.

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Notes: [1] Vanguard, "How asset location can boost after-tax returns" (July 2026). [2] Federal rates for 2026 from the TIAA 2026 quick tax reference guide. [3] California's top rate of 13.3% includes the 1% mental health services tax (US Tax Tools, California tax brackets); combined figures ignore the federal deduction for state taxes.