

Your investments: What about tax?

Tax considerations are not, and should never be, the be-all and end-all of investment decisions. The choice of assets in which to invest, and the way in which you apportion your portfolio among them, almost certainly will prove to be far more important to your ultimate results than the tax rate that you pay on your portfolio's earnings.

However, that said, when you make a decision on where to invest your money, understanding if, how or when your investments are taxed is important.

Here's a quick review of some of the pertinent rules:

Taxable investments. Regular income tax rates currently range from 10% to 35%, but certain income from your investments receives special treatment. For instance, most long-term capital gain is taxed at a maximum 15%. Qualified dividend income also is taxed at a maximum of 15%. Are stocks, then, more appealing as income-producing investments? Treasury bonds and notes and interest income are taxed at regular rates. But there's the risk factor to consider: A bond held to maturity should pay back your principal. Investing in stocks carries no such assurance.

Tax-exempt investments. Tax-exempt municipal bonds yield a lower return than taxable investments. Investing in munis will make sense only when the income from the lower yield will provide you with more income than the after-tax return that you would receive from a taxable investment. State taxes

need to be factored in as well. Munis issued in your home state are likely to escape taxation. The combination of escaping both federal and state income tax may make these bonds an appropriate investment.

Tax-deferred investments. Your contributions to a company retirement plan or an IRA may be tax deferred, and the income from the investments may be tax deferred as well. With your investment income unhindered by tax, your account can grow significantly in comparison with your taxable investments. But tax deferred is not tax exempt. Withdrawals become mandatory eventually and, in most cases, will be taxed at ordinary income tax rates. The 15% long-term capital gain and dividend income rates are unavailable, and, in the worst case scenario, return that would have been taxed at 15% is taxed at 35%. And, of course, tax rates are not set in stone. What is 35% now could be even higher when it comes time to take your money out of a tax-deferred plan.

The impact of taxes on a \$10,000 investment

The following table illustrates the potential impact of taxes when \$10,000 is placed in taxable, tax-free and tax-deferred investments.* We've made the following assumptions: You are eligible to receive a \$10,000 bonus from your employer. A federal income tax rate of 15% (on your long-term capital gain and

dividends) will be applied if you invest the bonus in stocks; a 35% rate if you invest in taxable bonds. No tax will be paid if you contribute the money to your company retirement plan account. The taxable stocks, bonds and company

plan investments each earn 7% a year; tax-exempt bonds earn 5% a year. (These returns are hypothetical and not based upon a particular investment.) All earnings are reinvested.

How a \$10,000 Bonus grows if you:

	Initial Investment (after tax, if applicable)	What you have after 10 years	What you have after 20 years
Put it in stocks	\$6,500	\$11,586	\$20,651
Put it in taxable bonds	6,500	10,143	15,827
Put it in tax-exempts	6,500	10,588	17,246
Put it into your company retirement plan	10,000	19,672**	38,697**

*No Social Security/Medicare tax has been factored into these numbers.

**Tax must be paid on withdrawals from a tax-deferred retirement plan. Assuming that you still are paying tax at the maximum 35% rate, what you would receive after tax after 20 years would be: \$25,153. If you are in a lower bracket, say 28%, you would net \$27,862.

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Any developments occurring after January 15, 2007, are not reflected in this article.

