NelsonCorp

Investments | Taxes | Medicare

CASH & TAXES

ALL CASH IS NOT CREATED EQUAL

Various cash and cash-like investments can have different risk profiles and tax implications. In terms of risk, this is largely due to differences in counterparties (US government vs. others). Tax implications can be wider ranging. These depend on who taxes the investment, at what rate it gets taxed, and when the taxation occurs.

CASH-LIKE INVESTMENT TAXATION

- **Ordinary Income Taxed by Federal and State Governments -** Savings accounts, checking accounts, CDs, some money market funds and accounts, and fixed annuities
- **Ordinary Income Taxed Only by the Federal Government -** Treasury bills, savings bonds, and some money market funds and accounts
- **Ordinary Income Taxed Only by State Governments -** Most municipal bonds issued by states other than your resident state
- **Not Taxed by Federal or State Governments -** Some municipal bonds issued by your resident state
- **Capital Gains Taxed by Federal and State Governments -** Certain cash management strategies like options box spreads

Ordinary Income vs. Capital Gains

Ordinary Income is taxed at rates ranging from 10% to 37%

Capital Gains are taxed at more favorable rates, ranging from 0% to 20%

TIMING MATTERS TOO

When it comes to paying taxes, it doesn’t just matter who taxes investments and at what rate. When those payments are due can also have significant impact.

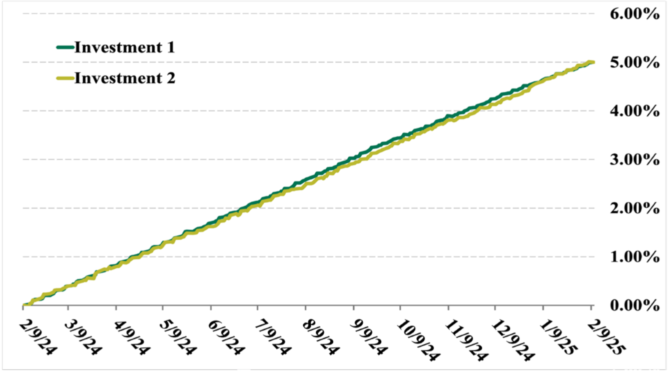
The ability to defer taxes can generate benefits by allowing money to stay invested longer. It can also allow investors the ability to shift income into later years, when their overall tax rate might be lower.

“It’s Not How Much You Make, It’s How Much You Keep.

HOW TAX DEFERRAL WORKS WITH CASH

There are a couple of ways taxes can be deferred on cash-like investments. The first way is that the investment can increase in price without making any distributions. In this instance tax isn't due until the investment is sold. This can occur with something like an options box spread.

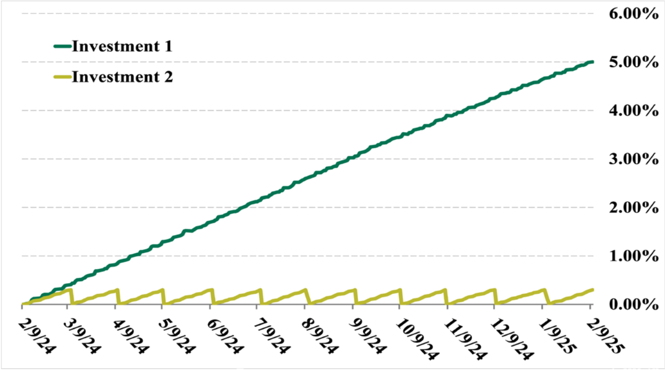
The second way is through the investment structure. For example, fixed annuities are not taxable until money is withdrawn. This structure can even defer tax on distributions of interest as it can accumulate that inside the vehicle. Another example is the Exchange Traded Fund (ETF) structure, where gains don't necessarily have to be distributed as underlying investments are bought and sold. This structure can only defer capital gains, not distributions like interest and dividends.



TOTAL RETURN

Total return represents an investment's performance inclusive of all price changes as well as dividend and/or interest payments.

The above chart shows two hypothetical investments, Investment 1 and Investment 2, that each have a 5% total return over a period of 12 months.



PRICE RETURN

Price return shows the change in an investment's price without reflecting any income distributions.

The above chart shows the price return of the same two hypothetical investments. Investment 1 accumulates all the gain in its price (allowing for deferral), while Investment 2 distributes all gain as income (resulting in realized tax).

CONSIDER STRATEGIC OPTIONS FOR CASH

Cash isn't generally given much thought by most investors. However, given the impact that cash choices can have on after-tax return, investors should carefully consider their options. If you have questions about what makes sense for you, consult a Financial Advisor.