STIFEL
INVESTING

Tax-Advantaged Investing

MOVE UP YOUR "TAX FREEDOM DAY"

Take your pick: 2 hours and 26 minutes of each eight-hour shift, 111 days, 15 weeks, or more than 3 months of the year.

In 2014, that's how long the Tax Foundation said the average American worked just to pay his or her taxes. "Tax Freedom Day," the day we began working for our families and ourselves, finally arrived on April 21. Until then, we worked, as did our investments, to pay taxes.

Now, the good news: Stifel can help you move up your "Tax Freedom Day." By developing a comprehensive strategy that maximizes the benefits of tax-advantaged investments, you may begin to reduce the taxes you must pay.

For example, tax-advantaged investments like government and municipal bonds may be exempt from federal and/or state taxes. Other vehicles, such as annuities, IRAs, and qualified retirement plans, may allow you to defer payment of taxes up until retirement or withdrawal. You can also take advantage of Roth IRAs and Education Savings Accounts that offer tax-free growth provided certain conditions are met.

Taxes (and other factors like inflation) can impact an investment's "real rate of return." That's why it's important to figure in taxes paid on earnings when calculating return. To do this, factor in the three parts of the "earnings rate" equation: 1) the rate you earn; 2) less the taxes you pay; 3) equals the amount you keep to spend or save.

Wouldn't you agree that the most important part of the equation is not what you earn but what you keep? Common sense tells us that to get ahead we need to either earn more from our investments or pay less in taxes. If you cannot currently increase your taxable rate of return because it would require you to increase your risk, one way to possibly increase your after-tax rate of return is to reduce the taxes you must pay.

Certainly, reducing your tax on investment income makes good sense.

Tax-Exempt Investing

Generally, government securities and municipal bonds are the only forms of tax-exempt investments. The interest earned from these securities is exempt from federal and/or state and local taxes. Most government bonds, T-Bills, and T-notes, plus municipal bonds, which are used to pay for a wide variety of publicly beneficial projects, offer investors distinct tax advantages.

By comparing the rates of return between government securities and municipal bonds and, say, stocks, you begin to understand the tax benefits of such investment vehicles. It is helpful to adjust the tax-free rates of government securities or municipal bonds to the "taxable equivalent" rates of other investments. This is the taxable rate that would have to be earned in order to net the same return as the tax-free investment, after paying income taxes.

To calculate this "taxable equivalent" rate, determine your federal marginal tax bracket and then use the following formula to calculate the "taxable equivalent" rate

on the tax-free investment: "Taxable Equivalent" Rate = Tax-Free Rate/(1 - Federal Tax Bracket Rate).

As a hypothetical example, assume the tax-free rate is 5 percent and the investor's federal marginal tax bracket is 33 percent. The "taxable equivalent" rate would be 7.46 percent (7.46 Percent = 5 Percent/(1 - .33). This indicates that the investor would have to yield 7.46 percent from an investment that was subject to federal income taxes to net the same 5 percent that the tax-free investment paid.

A portion of municipal bond interest may be subject to Alternative Minimum Tax or state and/or local income tax, and bonds sold prior to maturity may be subject to capital gains tax. Also, tax-exempt income may affect the taxable portion of Social Security benefits. Please consult with your tax advisor.

When investing in bonds, it is important to note that as interest rates rise, bond prices will fall.

Tax-Deferred Investing

You can take advantage of tax-deferred investments like annuities and tax-deferred programs like IRAs and qualified retirement plans. Such investments and programs are structured to encourage individuals to save for their own retirements. These vehicles receive tax-advantaged treatment, such as tax-deferred growth of earnings until funds are withdrawn.

However, individuals must comply with stringent requirements when utilizing such vehicles. For example, with IRAs and qualified retirement plans the amount of money that can be invested each year and what types of investments can be made may be restricted. There are also rules and regulations regarding withdrawals, investments, and programs. It is advisable to consult with your qualified tax expert about your specific situation.

The primary benefit of tax deferral is that, over time, the investment may accumulate more funds, producing greater retirement income.

The example that follows shows that even if the tax-deferred ending value was withdrawn and taxes paid, then the tax-deferred investment would still earn more than the taxable investment.

Let's assume a $100,000 purchase amount with a growth rate of 7 percent. A tax-deferred investment would be worth $107,000 at the end of the first year. A taxable investment could have earned the same $7,000, but it would have created a tax burden based on the individual's tax rate. To illustrate, we'll assume a 28-percent tax rate. Thus, the individual with the taxable investment must pay $1,960 in taxes at the end of the first year and has only $105,040 to reinvest for the next year.

For year two, the tax-deferred investment earns $7,490 ($107,000 x 7 percent) and the taxable investment produces only $7,353 ($105,040 x 7 percent) and creates a tax bill of $2,059, leaving only $5,300 to reinvest for the next year. At the end of year two, the tax-deferred investment is worth $114,490 and the taxable investment $110,334.

At the end of 15 years, a tax-deferred value of $275,903 minus taxes of $77,253 (28 percent) equals $198,650, or $10,434 more than paying taxes along the way.

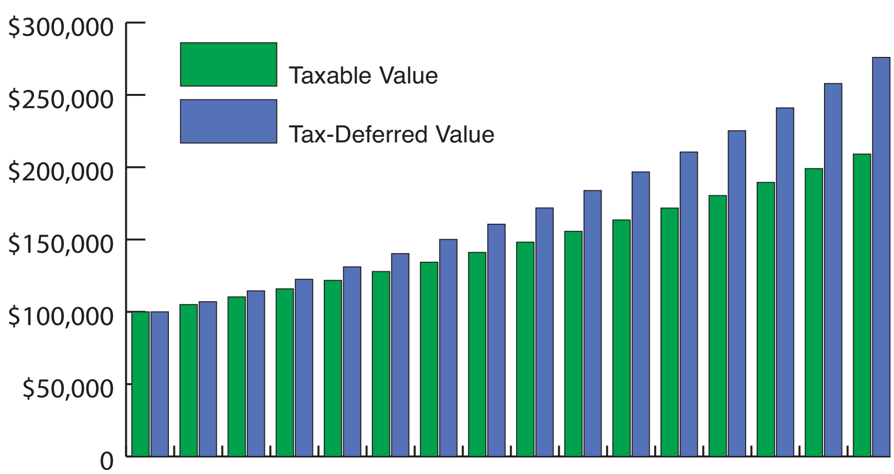
It is important to note that this example does not take into account that tax-deferred investments may have fees associated with them that taxable investments may not have. Annual contract charges, administration, investment costs, and other expenses are not reflected in this example and would lower the tax-deferred investment's return. Certain taxable investments may have more favorable tax rates, which would reduce the difference in value between the taxable and tax-deferred accounts. Changes in tax rates and tax laws may also impact the comparative results.

Investors should consider their personal investment horizon and income tax brackets, both current and anticipated, when making an investment decision, as these may further impact the results of the comparison. With a tax-deferred investment, earnings are taxed upon withdrawal and a 10% penalty tax may apply for withdrawals prior to age 59½ . A taxable investment's return and its relative advantage versus a tax-deferred investment may be impacted by investment losses as well as tax rates on capital gains and dividends.

Develop Your Tax Strategy

If you'd like to reduce the tax you pay on your investment income, please call me to learn more about the benefits of tax-advantaged investments. Together we may be able to design an effective strategy to help you move up your "Tax Freedom Day."

Taxable vs. Tax-Deferred: A 15-Year Comparison



The above is a hypothetical illustration only and does not represent the performance of any particular investment.