



**SELECT PORTFOLIO
MANAGEMENT, INC.**
Integrated Wealth Management
A Registered Investment Advisor



White Paper
Strategies to Defer Taxes

www.selectportfolio.com • Toll Free 800.445.9822 • Tel 949.975.7900 • Fax 949.900.8181

Securities offered through Securities Equity Group Member FINRA, SIPC, MSRB

Table of Contents

Strategies to Defer Taxes	3
What are some strategies to defer taxes?.....	3
How can retirement vehicles help you to defer taxes?	3
How can life insurance, annuities, and modified endowment contracts help you to defer taxes?	4
How can employment-related stock options help you to defer taxes?	5
How can Series EE savings bonds help you to defer taxes?.....	5
How can installment sales help you to defer taxes?	5
How can appreciating assets (stocks, bonds, real estate) help you to defer taxes?	6
How can like-kind exchanges help you to defer taxes?	6
Disclosures	6

Strategies to Defer Taxes

What are some strategies to defer taxes?

You should be aware of some of the tools available to defer the payment of taxes on your income. When tax rates are stable, it's wise for you to defer as much income as possible from one year to a later year in order to postpone payment of tax. This allows you the use of more money for a longer period of time. Postponing receipt of taxable income may also be useful, because when you eventually realize the income at a future time, it's possible that you'll be in a lower tax bracket.

Although there are a number of strategies for deferring taxes, some of the more popular tools include the following:

- Contributing to traditional IRAs
- Contributing to employer-provided qualified plans
- Contributing to nonqualified deferred compensation plans
- Purchasing life insurance
- Purchasing annuities
- Purchasing modified endowment contracts (MECs)
- Receiving compensation in the form of employer stock options
- Investing in Series EE savings bonds (which may also be called Patriot bonds)
- Selling assets in installment sales
- Investing in appreciating assets (stocks, bonds, real estate)
- Using like-kind exchanges

How can retirement vehicles help you to defer taxes?

Retirement vehicles, such as individual retirement accounts (IRAs), employer-provided qualified plans, and nonqualified deferred compensation plans, can be especially useful in deferring the payment of taxes on your income.

Traditional IRAs

If you qualify for a tax deduction for your contribution to a traditional IRA (the maximum contribution is \$4,000 for 2007; \$5,000 in 2008 and thereafter); individuals age 50 or older can contribute even more), your IRA contribution will lower your adjusted gross income for the year of the contribution (or, in certain instances, the prior year). Thus, you may be able to defer paying income taxes on your IRA contribution (and on the earnings in your IRA) until you decide to withdraw money from your IRA.

Tip: Although your contributions will not be tax deductible, the earnings that accrue on your contributions will grow tax deferred until you take an IRA distribution. If you leave your money

in the IRA until you retire, you may enjoy an added tax benefit if you are in a lower tax bracket when you start taking distributions.

Tip: If you meet certain income requirements, you can contribute to a Roth IRA. With a Roth IRA, contributions are not deductible, but qualified distributions are free from federal income tax.

Employer-provided qualified plans

Employer-provided qualified plans represent a particularly effective method of deferring the payment of taxes on your earned income. There are numerous varieties of such plans (one of which is the 401(k) plan), and numerous methods of contributing to such plans. Typically, a portion of your salary is deposited (by your employer) into the plan; you pay taxes on this portion (plus the earnings) only when you take a distribution from the plan. Thus, you are able to defer the taxation of part of your salary, and are able to take advantage of the tax-free build-up of your investment earnings. For more information, see *Sheltering Earned Income From Taxes*.

Nonqualified deferred compensation plans

Nonqualified deferred compensation plans are contractual commitments by an employer to an employee to pay currently earned compensation in a future year. Typically, the employee does not recognize taxable income currently (when it is earned); rather, he or she pays taxes when the money is received. Deferrals can be made from regular salary or from bonuses. As mentioned previously, one advantage of deferring the recognition of income is that you may be in a lower tax bracket at the time the deferred compensation is paid.

How can life insurance, annuities, and modified endowment contracts help you to defer taxes?

Although premiums are paid with after-tax dollars, insurance-related vehicles can defer taxes on accumulated earnings.

Life insurance

Life insurance cash values grow tax free until withdrawn or distributed. Certain life insurance benefits may also be received tax free by your beneficiaries.

Annuities

Annuities are arrangements in which you pay one or more premiums to an insurance company (or other financial institution) in exchange for the promise of a stream of payments representing a return of your premiums plus interest over some future period. You may be able to defer the payment of taxes of interest earnings until the money is withdrawn. Presumably, you will not begin to receive annuity distributions until the future, when you are in a lower tax bracket. When distributions occur, the interest

component of your annuity payments will be taxed at ordinary income rates. For more information, see Annuities.

Caution: Distributions before age 59 ½ may also be subject to a 10 percent federal penalty.

Modified endowment contracts (MEC)

An MEC is a class of life insurance contract that is treated differently than standard life insurance contracts, for federal income tax purposes. In contrast to the tax treatment of a standard life insurance contract, you cannot withdraw your basis or investment in a MEC tax free. Rather, when a distribution from a MEC occurs, it is first treated as taxable income (to the extent that the cash surrender value of the policy exceeds your investment in the contract), then as a recovery of capital or basis. Nevertheless, MECs, like standard life insurance contracts, serve as tools to defer the payment of taxes on earnings until the future. For more information about MECs, see Modified Endowment Contracts (MECs).

How can employment-related stock options help you to defer taxes?

Employer stock options and certain other forms of equity-based compensation can be excellent tools for income tax deferral. There are several forms of equity-based compensation, including incentive stock options, nonqualified stock options, and employee stock ownership plans (ESOPs). Of these three, incentive stock options (ISOs) perhaps offer the most favorable tax treatment from the standpoint of an employee. An employer stock option is a right or option granted by an employer to its employees to purchase shares of the employer's stock at a certain price, for a specified period of time. If an employer stock option qualifies as an ISO, the employee does not recognize any taxable income when he or she exercises the option. Instead, the employee recognizes taxable income or gain only when a disposition occurs (generally, this means when the stock is sold). The tax treatment of this disposition depends on whether he or she satisfies certain holding period requirements.

How can Series EE savings bonds help you to defer taxes?

The U.S. Treasury sells Series EE savings bonds at a discount. This discount is not included in the holder's income until maturity (unless the holder elects otherwise). As a consequence, you can use Series EE savings bonds to defer income taxes simply by not cashing them in right away. The interest received on Series EE savings bonds is exempt from state and local taxes. Furthermore, the interest received on certain Series EE bonds used for educational purposes may be exempt from federal income taxation if certain requirements are met. For more information, see Series EE Bonds for Education Savings.

How can installment sales help you to defer taxes?

If you must sell capital property (other than stock or securities) this year, you may be able to arrange with the purchaser to delay payment of part of the proceeds by having the payments made to you in installments over the next few years. This may be useful if you expect to have a substantial capital gain

from the sale of a capital asset. Under the installment method, you may be able to spread your gain from the sale over the taxable years in which you receive the installment payments (assuming that you report your income on the cash basis). In addition to allowing you to defer the payment of tax on a portion of the gain on the sale, the installment method may allow you to reduce your total tax liability resulting from the sale and minimize the chance that the sale will push you into a higher tax bracket in the year of sale. However, be aware that you may be required to impute interest income on the unpaid balance.

How can appreciating assets (stocks, bonds, real estate) help you to defer taxes?

If you're in a high tax bracket and you purchase low-yielding investments with capital gain potential, such as growth stocks, the current income tax liability generated by your investments will be minimized. You may then be able to hold these investments until after you've retired, when your marginal tax rate may be much lower.

How can like-kind exchanges help you to defer taxes?

Generally, if you trade business or tangible investment property for other business or investment property of a "like-kind," you will be able to defer recognition of gain or loss. While your gain will eventually be subject to income tax (when you sell or dispose of the like-kind property), you may be able to defer taxation for a number of years. A number of requirements must be met in order to qualify for like-kind exchange treatment. For more information, see Like-Kind Exchange.

Disclosures

This material does not constitute the rendering of investment, legal, tax or insurance advice or services. It is intended for informational use only and is not a substitute for investment, legal, tax, and insurance advice.

State, national and international laws vary, as do individual circumstances; so always consult a qualified investment advisor, attorney, CPA, or insurance agent on all investment, legal, tax, or insurance matters.

The effectiveness of any of the strategies described will depend on your individual situation and on a number of other factors. After reviewing your personal situation, we may recommend that you not use any strategy in this document but instead consider various other strategies available through our practice.

Securities offered through Securities Equity Group, member FINRA, SIPC, MSRB

Copyright 2006 Forefield, Inc. All rights reserved.