smartwomansecurities™

investing and taxes

february 26, 2007

glossary of terms

http://money.aol.com/basics/

Capital gain - A capital gain is an increase in the value of a capital asset that you own. The IRS defines a capital asset as almost everything you use for personal purposes or investment, including stocks and bonds, your home, personal property and collectibles. Capital gain is calculated as the sale price of the asset minus its basis. Basis is generally the price you paid for the asset and includes transaction costs. Capital gains are taxed at different rates depending on how long the asset is held. A long-term capital gain occurs if you hold the stock or bond for more than one year.

Brokerage Fees - Brokerage commissions are the fees that you pay a broker to buy or sell stocks, bonds or other securities. Brokerage fees are added to the cost of buying a stock or other security. They are added to your basis, which is the cost of buying a security. Brokerage fees lower investment returns

Taxable account - A taxable account is an account that does not receive the tax breaks that either a tax-exempt account or tax-deferred account are eligible to receive. (Both of these accounts are called tax-advantaged accounts. Tax-advantaged accounts are authorized by the IRS as investment vehicles to save for your retirement or the retirements of investors.)

Individual retirement account (IRA) - The two main types of IRAs are regular and Roth IRAs. Regular IRAs are also called traditional IRAs because they were the first IRAs. Regular IRAs allow you to make a tax-deferred yearly contribution of $4,000 in 2007. This account grows tax-deferred until you begin to take distributions, which you can do after you turn age 59-1/2. Roth IRAs require you to pay income taxes in the year that you make the contribution. You also can contribute $4,000 per year in 2007. Roth IRAs grow tax-deferred, and if you keep the account for at least five years and are at least 59-1/2, the entire account can be distributed tax- and penalty-free.

401(k) plan - A 401(k) plan is a defined-contribution plan that permits employees to have a portion of their salary deducted from their paycheck and contributed to an account. Federal (and sometimes state) taxes on the employee contributions and investment earnings are deferred until the participant receives a distribution from the plan (typically at retirement). Employers may also make contributions to the account of a participant. For 2007, you may contribute up to $15,500 to a 401(k) plan. If your employer makes contributions, the most that may be contributed (including forfeitures) to a 401(k) plan for 2007 is the lesser of $45,000 or 100% of your compensation.

Tax-advantaged account - A tax-advantaged account is an investment account with tax-deferred or tax-exempt features. The Internal Revenue Service authorizes the use of tax-advantaged accounts. These accounts are used to save for retirement or college and other educational expenses. Tax-advantaged accounts are tax-exempt until you take money out of the account. In some cases, distributions are tax-exempt provided the account holder meet certain conditions or the money is spent a certain way. In other cases, the entire amount of distributions is taxable.

Holding period - Holding period is the period you own an investment. Rate of return that you earn over this period is called the holding period return (HPR). For long-term capital gains, your holding period must be more than one year.

Capital gains tax - Capital gains taxes are those taxes that you owe on capital gains. The capital gains tax rate is lower than the tax rate on your ordinary income. To qualify for the capital gains tax rate, you need to hold a capital asset (such as an investment or home) for more than one year. Gains on capital assets held for more than one year are called long-term capital gains. Gains on capital assets held for one year or less are called short-term capital gains. Short-term capital gains are taxed at the same rate as ordinary income. The long-term capital gains tax rate for most taxpayers is 15%. However, if you are in the 10% or 15% income tax bracket, the long-term rate is 5%.

Dividends - Dividends are a distribution of profits that companies and mutual funds make to shareholders. Dividends are taxed as ordinary income and are often paid to shareholders on a quarterly (every three months) basis. You can reinvest your dividends in additional shares of a fund or stock or you can spend them.

Reinvesting - Reinvesting is the act of investing dividends and capital gains that you receive from a company or mutual fund into additional shares of the stock or fund. You may also choose to reinvest the dividends or capital gains in a different investment and interest rate. Investment performance of a stock or mutual fund often assumes that dividends and capital gains are reinvested in additional shares.

Total return - Total return is a rate of return that measures the investment performance of stocks, bonds, and mutual funds that invest in stocks or bonds. Total return assumes the investor reinvests any coupon or dividend income in additional shares or bonds. Realized or unrealized capital gains (change in the price of the security) are also included in the calculation. For periods longer than one year, the rate of return is generally shown as an annualized rate.

a closer look at investing and taxes

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- Whether you invest in a mutual fund, buy a CD, or purchase a stock your investment usually generates investment income. Mutual funds are professionally managed companies that invest in securities and pass on most of their income to investors who buy shares of the fund. In the case of stocks and mutual funds, income is earned as dividends. Dividends make up a type of investment income that is taxed at the same rate as capital gains.
- In the case of bonds and savings deposits, income is earned as interest. Interest is an expense that the company is paying to you. Interest makes up a type of investment income that is taxed as ordinary income. Ordinary income includes wages, salaries and other income that is not considered as capital-gains income.
- If you earn more than $400 in dividends or interest with a taxable account, the Internal Revenue Service requires you to complete an additional schedule with your 1040 Form. Each institution that pays you dividends or interest is required by law to mail you a Form 1099 by Jan. 31 to help you gather the information necessary to file your income tax return.
- If you invest in a taxable account, your dividend and interest income is, naturally, taxable. But if you invest in a tax-deferred account -- an IRA or 401(k) plan for example -- you don't report the income until you begin to take distributions from the account.
- A common mistake occurs if you reinvest dividends earned on a stock or mutual fund. Reinvesting is a common investing strategy that consists of rolling over investment income into additional shares of the stock or fund. Investors sometimes think, mistakenly, that they don't have to report reinvested dividends and capital gains as income since they don't handle the money. In fact, they must report reinvested income on their tax returns.
- In the U.S., dividends are often paid four times a year. Bond interest is usually paid twice a year. The frequency that you receive dividends and interest -- your investment cash flows -- contributes to the total return you earn on an investment. Total return includes capital gains and any reinvested dividends or interest.
- When you file your income tax return, you can add certain expenses such as brokerage fees to calculate the basis of the asset. Increasing the basis allows you to report a smaller capital gain. For example, if you paid $1 in brokerage fees to buy your $15 share, your basis would be $16. If you sold the share for $20, your capital gain would be $4.

smart woman securities and taxes

Smart Woman Securities is in the process of acquiring a 501c3 registration, which will allow it to be a tax-exempt vehicle. To learn more about the legal structure of SWS, please contact Tracy Britt or Teresa Hsiao, SWS Co-Founders at tbritt@smartwomansecurities.com or thsiao@smartwomansecurities.com.