CPA Practice Advisor

Inflation Protection securities—or TIPs, for short. TIPs are U.S. Treasury bonds designed to provide protection to investors during times of ...

Apr. 07, 2022

Now that inflation is on the upswing, it's likely you'll be hearing more about Treasury Inflation Protection securities—or TIPs, for short. TIPs are U.S. Treasury bonds designed to provide protection to investors during times of rising inflation. But there are numerous factors to consider, including the tax repercussions, before you make a commitment to TIPs.

How does it work? TIPs have unique investment components. Essentially, the principal of the TIPs increases with inflation and decreases with deflation based on changes in the Consumer Price Index (CPI). When the security matures, you're paid the adjusted principal or original principal, whichever is higher.

TIPs pay interest twice a year at a fixed rate. The rate is applied to the adjusted

purchase TIPs via a broker or at a bank. Of course, the online method is usually easier and more convenient.

TIPs are issued with maturities of five, ten or 30 years. (So you can buy TIPs today that won't mature until 2052.) You can hold these securities until they mature or sell them before the maturity date. Because TIPs are obligations of the U.S. government, like regular Treasury bonds, they are generally considered to be one of the safest investments around.

What are the tax consequences? Unlike their close cousins, U.S. Series I bonds, TIPs don't benefit from tax deferral, The semi-annual inflation adjustments of a TIPS bond are treated as currently taxable income even though you don't actually receive the money until you sell the bonds or they reach maturity. This is generally viewed as a downside to TIPs.

Conversely, you have more tax flexibility with Series I Bonds. If you do nothing, the interest income is deferred until you sell the bonds or they mature, whichever comes first. Alternatively, you can elect to pay tax on the I bonds annually.

For this reason, some investors include TIPs in their qualified retirement plan accounts and IRAs, where permitted, so the annual income is effectively tax-deferred until withdrawals are made. This avoids any current tax consequences.

Discuss this option with your professional tax and financial advisors if you're inclined to invest in TIPs. Compare them to I Bonds and other investments offering inflation protection. Then make an informed decision.

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