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Year-End Tax Savings Idea, First in a Series: Capital Gains Distributions - Be Aware and Take Action

TAX, WEALTH MANAGEMENT

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Every year, mutual funds are required to distribute any net realized capital gains to their shareholders regardless of whether the fund had a positive or negative return for the year. These distributions are then subject to capital gains tax rates to shareholders who hold the funds in taxable accounts. Capital gain distributions can be either short-term, taxable at ordinary income tax rates, or long-term gains, taxed at long-term capital gains rates.

So, how can you as an investor mitigate these taxes? First you should determine the amount of the capital gain to see if it may be worth selling that fund prior to its record date (if you own shares on the record date you are eligible to receive the distribution). If you have a loss in the fund, you can sell the fund and recognize the loss avoiding the tax on the distribution. However, if you have a large gain it may not be worth selling. If you do not sell the fund, review your asset allocation to determine whether or not to reinvest the distribution. If you need to rebalance, take the distribution in cash. You are going to pay tax either way, so taking the cash allows you to lower your position size without making a sale in the future and perhaps realizing more gains.

Second, don't buy into a capital gain distribution. If you are looking to add to your holdings know the important dates to avoid the distribution and the tax associated with it. Understand what the record date, ex-date, and payable date are so that you can make smart investment decisions. For example, if the fund has a record date of December 1st, delaying your purchase until December 2nd will avoid you receiving the taxable distribution.

Lastly, think about what types of investments to put into your taxable accounts if you want to avoid paying taxes on these distributions in future years. Consider positioning your tax-deferred accounts with the tax-inefficient funds and holding tax efficient funds in your taxable account. You should talk to your advisor about what strategy or strategies might work for you.

Contact us if you have questions regarding capital gains distributions and visit the Schneider Downs Wealth Management Advisors webpage to learn about the services that we offer.

You've heard our thoughts... We'd like to hear yours

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After all, a dialogue is an exchange of ideas, and we'd like to hear from you. Email us at contactSD@schneiderdowns.com.

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