



Mutual Fund Taxes

Compare Ways to Invest in Funds

Mutual funds have many advantages including professional money management and portfolio diversification. Keep in mind though, when you own mutual funds, your investment may be subject to taxable events. The following information regarding taxable events only refers to mutual funds that you own in taxable accounts, and not in tax-deferred accounts such as an IRA or 401(k) plan.

Taxable distributions

A mutual fund company generally does not pay taxes on your behalf, so it's important to monitor your account, and report all taxable distributions when you file your income taxes each year. A mutual fund company will send you a Form 1099-DIV that summarizes the taxable distributions it made to you during the year (if any).

Taxable distributions include:

- **Dividend distributions**

Fund portfolios may hold securities that pay dividends. A fund company passes these dividends, minus fund expenses, on to the fund's shareholders. A portion of these dividends may qualify for special tax treatment (maximum rate of 15%) but other portions may not qualify. You may elect to have dividends reinvested to purchase more shares of the fund at the time of the distribution, but reinvesting dividends does not change your tax liability.

Note: Some funds, such as municipal bond funds, invest in municipal debt securities, which may provide income that is exempt from federal income tax and, in some cases, state income tax as well. Before you invest in a municipal bond fund, you should read the prospectus carefully to see if the tax benefits from the fund may be appropriate for your situation. Please keep in mind that you may be subject to state and local taxes as well as the federal alternative minimum tax when owning municipal bond fund shares.

- **Capital gains distributions**

Mutual funds purchase and sell investments on behalf of the fund's shareholders. When the fund sells investments for a long-term gain, it may treat a portion of its dividend as a capital gain distribution, taxable to you at a maximum rate of 15%. As with dividends, you may generally elect to have capital gains distributions reinvested. And, as with dividends, capital gains distributions you receive from a fund (whether or not you choose to reinvest them) will be taxable.

Capital gains from the sale of mutual fund shares

In addition to any capital gains distributions you may receive while you own a mutual fund, you may also sell shares of a fund for a capital gain or a capital loss. You will generally realize a capital gain if you sell your fund shares for more

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than you paid for them, taking sales charges into account. This capital gain is taxable.

Short-term gains are subject to ordinary income tax rates, which could be as high as 35% at the federal level. Long-term capital gains are subject to a special 15% federal tax rate; 5% for investors in the 10% or 15% bracket.

To calculate your capital gains, you may choose from one of the following methods:

- **First In First Out (FIFO):** This method assumes that the first shares you sold came from the first shares you purchased, so you use the share price from the oldest purchase date.
- **Specific Shares Method:** This method requires you to "adequately identify" which shares you want to sell by specifying their original purchase date at the time you sell them. You must also retain a written confirmation of the transaction from your broker or from the fund company.
- **Average Cost Per Share, Single Category Method:** With this method, you divide the total cost of all your shares by the total number of shares owned to arrive at an average cost per share.
- **Average Cost Per Share, Double Category Method:** This method involves two steps. First, you separate the shares into short-term (owned a year or less) and long-term (owned more than a year) categories. Then you determine the average cost per share in each category. After that, you must specify from which category you want your shares sold, and then follow the requirements of the Specific Shares Method.

You can switch back and forth between using the default FIFO method and specific identification. You can also elect to use an averaging method after using FIFO or specific identification or both. **However, once you elect an averaging method, you must use that method for all future sales from the same fund.**

Avoid Double Payment

If you automatically reinvest your dividends and capital gains distributions, you should keep all your statements for accurate records when it comes time to sell. That's because you have already paid taxes on your reinvested dividends, so you can subtract both your original contribution plus the total amount of reinvested money from the market value of your investment.

This will reduce your capital gains tax liability. Investors who forget to do this end up paying double taxes on their reinvested dividends, first in the year the dividend is paid and then again when they sell the mutual fund shares.

Investment Products: • Not FDIC Insured • No Bank Guarantee • May Lose Value

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