Mutual Fund Distributions

The effect on mutual fund cost basis

	Long-term capital gain rate (longer than one year)		
	0%	15%	20%
Single	$0 - $38,600	$38,600 - $425,800	$425,800 +
Married filing jointly and surviving spouse	$0 – 77,200	$77,200 - $479,000	$479,000 +
Head of household	$0 – 51,700	$51,700 – $452,400	$452,400 +
Married filing separately	$0-$38,600	$38,600- $239,500	$239,500 +
Trusts and estates	$0-$2,600	$2,600- $12,700	$12,700 +

Determine your capital gain bracket by adding your net long-term capital gains and/or qualified dividends to your other taxable income net of deductions.

For example, assume a joint filer has net taxable income of $90,000 which includes a $10,000 long-term capital gain. Since the gain (after adding other taxable income) falls between $77,200 and $479,000, the gain will be taxed at 15%.

Short-term capital gain rate (one year or less)	Taxed at ordinary income tax rate.
Dividends	Qualified dividends are taxed at the long-term capital gain rates. Nonqualified dividends are taxed at ordinary income tax rates.

Source: *Wells Fargo Advisors 2018 Tax Planning Tables*

Many investors have many questions surrounding the dividend and capital gains distributions they receive from mutual funds throughout the year and at the end of the year. Mutual fund shareholders have a number of considerations to review when they receive distributions.

Mutual Fund Distributions

Mutual funds are required by law to pay out any net income or realized capital gains to investors. Income can come from stock dividends or bond interest, and most mutual funds pay regular dividends to distribute this income. When a stock or bond is sold at a profit, the result is a realized capital gain. If a fund has net realized gains for the year, those gains are paid out as capital-gains distributions. As a mutual fund investor, you can have these distributions reinvested into more fund shares, compounding the growth of your mutual fund.

Taxes on Distributions

If you own shares of a mutual fund, the fund will send you a IRS Form 1099 at the end of the year listing the amounts of dividends and capital gains paid on your investments. You must claim the distributions on your taxes, even if they were reinvested in more shares. Fund distributions are taxed for the year they were paid; as a result, the reinvestment shares were purchased with after-tax money. From a cost-basis standpoint, buying shares through reinvestment is the same as sending a check to the mutual fund company to buy shares.

Cost Basis Accounting

Your cost basis in a mutual fund account will be the total of the amounts of money you have invested plus the dollar amounts of reinvested capital gains and dividends. The distributions are part of your total earnings from the fund, but since they are taxed when paid, they are also included in your cost of the investment.

A higher basis can be a good thing because you will pay less in capital gains taxes with a higher basis if you sell your fund shares. Tracking your cost basis will prevent double taxation of the distributions paid into your mutual fund account.

Common questions received

I received a 1099-DIV showing a capital gain from my mutual fund. Why do I have to report capital gains from my mutual funds if I never sold any shares?

You own shares in the fund, but the fund owns assets such as shares of stock, corporate bonds, government obligations, etc. One of the ways the fund makes money for you is to sell these assets at a gain. If the asset was held by the mutual fund for more than one year, the nature of the income is long-term capital gain, which gets passed on to you. These are called capital gain distributions, which are distinguished on Form 1099-DIV from other types of income such as ordinary dividends.

Long-term capital gain distributions are taxed as long-term capital gains regardless of how long you have owned the shares in the mutual fund. If your capital gain distribution is automatically reinvested, the reinvested amount is the cost basis of the additional shares purchased.

If my mutual fund has lost value, why do I have to pay tax on capital gains distributions?

Mutual funds must distribute most of their income to their investors annually to meet requirements of the Internal Revenue Code. As a result, mutual funds pass through taxable income unchanged to its shareholders which could be in the form of ordinary dividend, qualified dividend, capital gain distribution, etc. on a 1099-DIV. Funds that have net long-term capital gains in their trading activity pass the gains to the shareholders who must report the gains as income and pay tax on it regardless of whether their personal investment in the fund is up or down in value due to market activity.

Why is my statement showing a loss if the value of my fund is up for the year?

There could be a couple of reasons why the value of the fund is up but the statement shows a loss.

"Up-for-the-year" does not mean the fund is up from the initial purchase of the shares. The fund could have been down in prior years while you owned it.

Basically when you reinvest dividends, whether capital gains or other distributions, the total cost basis increases but the overall value of your shares of the fund may remain the same.

If I used an average cost basis method for shares of one mutual fund I sold, do I have to use it for all the mutual funds I sell?

No, you may use a different cost basis method for shares in a different mutual fund. However, once you have elected to use an average cost basis method to compute the gain or loss on shares in a specific mutual fund, you must use that same method for the sale of shares from any account in that same mutual fund until it is completely sold off.

Generally, electing an average cost method puts the taxpayer at a disadvantage. Using average cost prevents the investor from electing certain tax strategies that would otherwise be available.

What taxes do I potentially have to pay?

Mutual fund shareholders generally pay federal and, in many cases, state and local income taxes, including taxes on dividends and capital gains. Shareholders who own mutual funds outside of tax-advantaged accounts are taxed each year on two types of transactions: distributions from the fund and the sale of fund shares.

Can I offset my capital gain distribution with the loss in value of my fund shares?

No. Capital gain distributions can only be offset with capital losses you have incurred during the year.

Common questions continued

Wells Fargo Advisors wants to ensure that you are investing in the mutual funds and the share classes that best suit your investment objectives, risk tolerance, time horizon and diversification needs.

If you have any questions about your mutual fund investments, please contact your Financial Advisor.

As long as you continue to hold your fund shares, their loss in value is unrealized. That reduction in value can only be used to offset your capital gain distribution if you actually sell those shares at a loss before the end of the year.

What factors influence the size of a capital gain distribution?

It's important for shareholders to remember that the capital gain distribution reflects the gains recognized by the trading activity of the fund manager during the year, which in turn are based on when and at what price the manager originally purchased the security.

What can I do to alleviate capital gains distributions?

If you're facing large capital gains distributions, look around your investment portfolio for losses that you might realize to offset those gains. Review with your financial advisor and your tax advisor what strategies may be suitable for your specific situation.

Can you give me an example of how my cost basis would be adjusted after receiving a dividend?

Assume that you currently own 120 shares of a fund, purchased in the past at a price of $8 per share, for a total cost of $960. The fund pays a dividend of $0.40 per share, so you are due to receive $48, but you have already decided to reinvest the dividends in the fund. The current price of the fund is $12, so you are able to purchase four more shares with the dividends. Your cost basis now becomes $8.1290 ($1008/124 shares owned).

When I compare my cost basis to my current account value, can I use that as a guide to what I've gained or lost?

Remember that your cost basis has increased due to the reinvested dividend so using that number is not an accurate reflection of your total gain/loss over the length of your holding period. From the scenario about, let's say your account value drops to $1000. As you only invested $960 originally, you still have a gain of $40.

Common questions continued

Will tax managed mutual funds allow me to avoid capital gains distributions completely?

No. In general, tax managed mutual funds are designed using a variety of investment strategies with the end goal of minimizing taxes. Tax managed funds are available in an array of market capitalizations and focuses, affording investors the ability to create a well diversified portfolio. These types of funds are intended to demonstrate lower turnover of underlying assets when compared to more actively managed mutual funds, and may result in lower capital gains distributed to shareholders.

Why does the fund value (NAV) drop when a capital gain distribution is paid?

Fund managers buy and sell securities throughout the year, sometimes at a profit and sometimes at a loss. When profits outweigh losses, they accumulate and contribute to the rise of the net asset value (NAV), or share price of the fund's shares. When that profit is paid out to shareholders as a capital gain distribution, its NAV will be reduced by the amount of the distribution. However, this does not mean that investors are losing money. Investors can either take capital gain distributions in cash or reinvest them. If capital gains are reinvested, the number of shares in the account will increase, leaving the total value of the account unaffected by the distribution.

All investing involves risk including the possible loss of principal. An investment in a mutual fund will fluctuate and shares, when sold, may be worth more or less than their original cost.

Dividends are not guaranteed and are subject to change or elimination.

Wells Fargo Advisors is not a legal or tax advisor. Consult with your own legal and tax advisors before taking any action that may have tax or legal consequences.

Wells Fargo Advisors is registered with the U.S. Securities Exchange Commission and the Financial Industry Regulatory Authority, but is not licensed or registered with any financial services regulatory authority outside of the U.S. Non-U.S. residents who maintain U.S.-based financial services account(s) with Wells Fargo Advisors may not be afforded certain protections conferred by legislation and regulations in their country of residence in respect of any investments, investment transactions or communications made with Wells Fargo Advisors.

Wells Fargo Advisors is a trade name used by Wells Fargo Clearing Services, LLC and Wells Fargo Advisors Financial Network, LLC, Members SIPC, separate registered broker-dealers and non-bank affiliates of Wells Fargo & Company. CAR 0918-03263