



## Frequently asked questions

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**Q. What are mutual fund capital gains?**

**A. *Shareholder Transactions Capital Gains***

When a shareholder sells or exchanges their shares held in a mutual fund at a price that is greater than their original purchase price, the shareholder will realize a capital gain on their investment. For example, a shareholder purchases Mutual Fund A for \$50 per share and decides to sell the shares later for \$75 per share, the shareholder will realize a gain on their investment in Mutual Fund A of \$25 per share.

***Portfolio Investment Sales Capital Gains***

A mutual fund buys and sells investments that are held in the fund's portfolio. The mutual fund realizes a capital gain when it sells an investment and the sale price of the investment is greater than its original purchase price. The mutual fund realizes a capital loss when the investment sale price is less than the original purchase price. In general, realized capital gains that exceed realized capital losses equal net realized capital gains.

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**Q. Why are mutual fund capital gains distributed to shareholders?**

**A.** US tax law requires a mutual fund that is taxed as a regulated investment company to distribute substantially all its net realized capital gains generated from sales of portfolio investments to its shareholders to avoid a nondeductible excise tax to be imposed on the mutual fund. A mutual fund, by distributing its capital gains to shareholders, generally pays no federal income tax on such gains at the mutual fund level. Net realized capital gains from portfolio investment sales in mutual funds are distributed to the mutual funds shareholders at least once a year to satisfy federal excise tax rules.

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**Q. Why does the Fund's net asset value (NAV) drop after a capital gain is paid?**

**A.** At the time a shareholder purchases mutual fund shares, the fund's NAV may reflect and include undistributed income, undistributed capital gains, or net unrealized appreciation in the value of portfolio investments held by the fund. Buying shares in a fund just before it declares an income dividend or capital gains distribution is sometimes known as "buying a dividend." When a mutual funds pays a capital gain and or income distribution to its shareholders, its NAV is reduced by the amount of the distribution. For taxable shareholders, a distribution of such amounts, although constituting a return of investment, is taxable. Market activity on investments held in the mutual fund can also impact the mutual fund's NAV so the change in the NAV on the ex-date of the distribution may be more or less than the amount of the distribution.

A decrease in a fund's NAV due to a distribution does not impact the total value of a shareholder's investment (unless there is a decrease in the market at the same time, causing an additional drop in the value of the fund's shares.)

Example: Mutual Fund A has a NAV of \$50 per share which includes capital gains of \$5 per share. When the fund makes its capital gain distribution the fund share price will decline to \$45 per share. The investor will now have \$5 per share either in cash or shares back into the fund. Reinvested dividends are purchased at the new lower price of \$45 per share.

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## Q. What are the tax consequences to shareholders when capital gain distributions are paid by the fund?

**A.** Distributions from mutual funds normally are taxable to the shareholder when paid, regardless of whether the shareholder reinvests the distributions or receives them in cash (unless the shareholder's shares are held in a qualified tax-advantaged plan or account or are otherwise not subject to federal income tax). Taxable mutual fund shareholders are required to include capital gain dividends received from mutual funds on their federal income tax return and if applicable, state and local tax returns. Reinvested distributions and cash distributions must be disclosed on the shareholders tax return even if the funds NAV has declined during the year.

The applicable tax rate depends on how long the mutual fund held the portfolio investment prior to its sale and the individual shareholder's ordinary income tax bracket.

Portfolio investments held in the mutual fund for more than one year result in long-term capital gains when sold and distributions of such gains to individual shareholders are taxed at a rate between 0% and 20%, depending on such shareholder's tax bracket.

Portfolio investments held in the mutual fund for one year or less result in short-term capital gains when sold and distributions of these gains to shareholders are taxed at ordinary income tax rates.

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## Q. What are the tax consequences when shareholders sell or exchange their fund shares?

**A.** Taxable mutual fund shareholders that sell or exchange their mutual fund shares may realize a capital gain or loss, which is long-term or short-term depending on a mutual fund's and a shareholder's holding period of mutual fund shares and which is subject to federal income tax.

State and local taxation of capital gains vary from state to state and may differ from federal taxation. Shareholders should consult with their tax advisor for more information on state and local tax reporting of capital gain distributions and capital gains realized as a result of sales or exchanges of mutual fund shares.

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## Q. Where can a shareholder find the amount of each fund's capital gain distribution?

**A.** Shareholders can find capital gain information at [Mutual Funds Dividends and Capital Gains](#).

**This Q&A applies generally to mutual fund shareholders who are individuals.**

**The foregoing information is not intended or written to be used as tax advice. Because everyone's tax situation is unique, you should consult your tax advisor about federal, state, local or foreign tax consequences of an investment in a mutual fund.**

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