



MINIMIZING TAXES ON YOUR LOSING MUTUAL FUND

The headlines and articles have been calling it “adding insult to injury.” Many mutual fund shareholders are going to be paying taxes on year-end distributions from stock mutual funds despite the fact the funds may have lost money for the year. While this may surprise shareholders who thought a declining market would mean a declining tax bill, it’s not necessarily as bad as it appears. In some cases, investors can take strategies to minimize the tax bite.

Paying taxes on the distributions of a fund that’s lost money during the year is nothing new, of course. It happens every year to some funds. This year is worse than usual, however, because many more funds than usual have lost money for the year, plus their losses follow three robust years.

The problem is really two-fold. First, as the market peaked earlier in 1998 and began to decline in mid-summer, some mutual fund managers edgy about the high valuation of the market, sold off long-term winners that had accumulated sizable gains.

Once the market started downhill, particularly after the big drop on August 31, increasing numbers of shareholders also sold off their shares, forcing fund managers to sell stocks in order to meet redemptions. The double-whammy means a heavier-than-usual year-end distribution to shareholders still invested. In some cases, distributions are 15 to 20 percent of the funds’ net asset value.

You may already have received, or will receive during December, an ex-dividend declaration from your mutual funds. What should you do if the fund was a loser during the year and the distributions are heavy?

First, it’s not a problem at all if the fund is inside a tax-favored account, such as a retirement plan, variable annuity or individual retirement account. You won’t pay taxes on any fund distributions until you start withdrawing money from the account.

Second, you may want to stay in the fund, even if it’s down for the year. You’ll still have to pay taxes on this year’s distributions, whether you reinvest them or not, but you would have paid taxes on distributions even if the fund had made money for the year.

However, you may want to consider doing some tax-loss selling before 1998 ends (it's best to consult with your Certified Financial Planner practitioner or tax accountant before proceeding).

This means selling off some losing investments to offset your gains, such as those large distributions. You can offset any amount of gains with losses. If your losses exceed the gains, you can use up to another \$3,000 in excess losses to offset regular income. Anything above the \$3,000 in excess losses can be carried over into next year to offset gains. You can carry forward \$3,000 in excess losses a year each year indefinitely.

Assuming you want to sell one or more losing mutual funds, keep these points in mind.

- Get an estimate from the fund company of its year-end distribution.
- Calculate your adjusted basis in the fund (original investment plus reinvested dividends and capital gains) to make sure the fund really is a loser for you. The fund may be down for the year, but it still may be well above where it was when you began investing in it.
- Sell off funds that are doing worse than their peers.
- You can sell off a losing fund and buy it back later to avoid upsetting your portfolio mix. Just don't buy it back within 30 days, or the IRS will call it a "wash sale" and not let you take the loss.
- You can sell off a fund and buy a similar fund—but not too similar. Selling one index fund and buying a similar index fund will be treated like a wash sale.
- Don't sell off a good fund just for tax-loss purposes. Even if you intend to stay out of the fund only 31 days, you could miss significant increases. Many funds that were down in late September had fully recovered by late November.

Before selling a losing mutual fund to offset a distribution, look at your other investments as well. You might have individual stocks or rental property or other types of investments that you've been looking for a good excuse to unload.

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