Higher Investment Returns Mean Higher Capital Gains Taxes

By Nick Burroughs

Perhaps one of the most welcome emails or memos people receive at work is the one that starts with "FYI" and ends with "No action required."

This commentary about capital gains taxes fits the same category, but investors nonetheless need to be aware that their capital gains could be a lot heftier this year.

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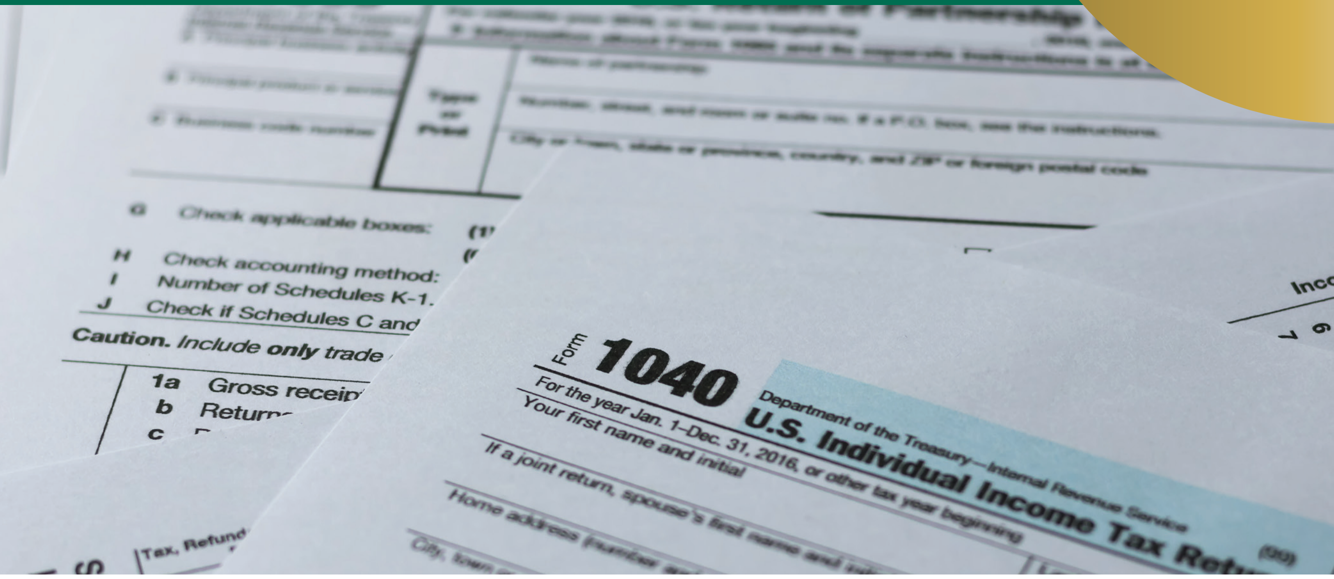
No action required. Revel in the moment because your equity investments probably did very well this year. After all, is this not why we invest?

Yes, it's great when the value of an investment in your portfolio rises, but just remember there's a side to that success that's much less appealing: you could pay more in taxes for the privilege of having a good run.

Because U.S. stock markets have largely been on a 100-month expansion – the third-longest running in history – it is likely that mutual fund managers will rebalance some gains from high-performing investments and redeploy them in other opportunities.

Capital gains, and their cousins dividend income, are the payments shareholders receive when a fund sells its holdings at a profit, or passes along dividends or interest. Mutual fund companies generally start declaring distributions and capital gains for their funds in November of each calendar year.



If your portfolio is being managed by a professional advisor, he or she might have the back-up of a research staff in moving the chess pieces within your portfolio to gain tax efficiencies. They can employ all kinds of strategies, like selecting low-turnover funds or offsetting some of these capital gains through tax-loss harvesting strategies.

It's tougher for investors who self-manage their portfolios as they have to keep up with key dates associated with fund distributions. Even after successfully navigating those dates, a second decision must be made in determining what appropriate fund will be chosen to offset the distribution.

Many other factors must be considered as the tax rates you pay depend upon how long a fund has held a stock or a bond. A short-term investment (less than a year) is taxed at ordinary tax rates and a long-term investment of a year or more is taxed at the capital gains rate.

All of this must be done before year-end as the IRS sends out 1099s in February.

So, FYI – No action necessary. But December is a nice time to check in with your advisor to make sure he or she is on top of last-quarter action when it comes to distributions and tax efficiencies in your portfolio.

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Nick is a portfolio manager for Commerce Trust Company. Upon gaining a thorough understanding of a client's needs and goals as well as assessing the client's entire financial situation, he works with our investment research team to construct a portfolio to help clients achieve their long-term goals. Nick comprehensively represents our research- and goals-based investment process, starting with the initial assessment and creation of an investment objective to ongoing evaluation and adjustments based on changing market and life circumstances. With a deep knowledge of the market and experience in investment management, he serves clients with thought leadership, insight, and consulting services. He received his bachelor of business administration degree in accounting from Wichita State University in 1986 and earned the designation of Certified Public Accountant in 1989.

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