Approaching Zero Taxes: Attempting to Avoid Funds in the Doghouse!

The investment industry and academia largely ignore tax implications and instead focus on return and risk. One of our key maxims at Savant is **tax-efficient investing**. We believe incorporating tax ramifications is the critical third leg to the investment management stool (risk, return, and taxes). As we approach the end of 2019, it's relevant to discuss one aspect of the taxes leg of the stool: **capital gains**.

There are two basic types of capital gains: 1) capital gains and 2) capital gains distributions. If you sell an investment for more than its cost basis (its purchase price adjusted for dividends and distributions), that's a capital gain. This type of gain can be long or short-term depending on how long you have owned it. The second type, capital gains distributions, occur as a result of fund managers buying and selling holdings throughout the year and are then legally required to pass profits from those sales on to shareholders—known as capital gains distributions. Unfortunately, the end investor must pay taxes on these distributions. Capital gains distributions can catch you off guard if you are not familiar with what they are and how they work. It is important to educate yourself on how they might affect your tax bill every April. Here are three things to keep in mind:

1. **Capital gains distributions are not caused by anything on your part.**
2. **The fund's return for the year does not indicate whether you will receive a capital gains distribution or not.** For example, a fund manager could sell underlying holdings at a profit, but the overall fund could end up negative for the year. The fund may still have to distribute the gains on the shares sold at a profit.
3. **Capital gains are different than dividends.** Dividends are typically paid by companies on regular intervals as a share of earnings. So if you own stocks directly, the dividends are paid from the company to you as the shareholder or to the mutual fund who is the shareholder.

What does Savant do on behalf of clients?

Savant does not want to select funds for our clients that pay out hefty capital gains distributions which in our view puts them in the doghouse! So far in 2019, we have seen some funds in the industry announce big capital gains distributions estimates ranging between 10% and 30% of net asset value. Your financial advisor can provide specific details on your portfolio distribution estimates. We are continuously attempting to minimize tax obligations on behalf of our clients.

- We make all efforts to utilize extremely tax-efficient and tax-managed funds.
- We put investments in the most optimal accounts based on their tax properties. This is often referred to as asset location or tax-engineering your portfolio.
- We utilize a tax-loss harvesting strategy to help offset gains. Ideally, losses are harvested by selling investments in a disciplined and systematic manner to capture and preserve the losses for current and future use to offset gains.
- Toward the end of each calendar year, we accumulate estimates of capital gains distributions from fund managers in order to proactively avoid purchasing or in some less common cases sell investments.

Capital gains distributions can be an unpleasant surprise for investors with taxable accounts. No investor sets out to pay more taxes than necessary when selecting investments. By doing all of the aforementioned, Savant intends to help investors keep more of their return instead of paying it back to the government in April. More information on how to help increase the tax efficiency of your portfolio, check out our white paper, *Approaching Zero Taxes*, which can be downloaded from our website.

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