# Creating Tax Alpha in Your Mutual Fund Investments:
## Three Actions to Take Right Now

Terri Spath, CFA, CFP®
Chief Investment Officer, Sierra Investment Management

When it comes to the timing, likelihood and economic impact of a potential tax overhaul, who wins? Who loses? The answer is: Who knows? What we do know right now, though, is how to manage taxes between now and year end to minimize the bill.

Tax alpha is money saved from profitable tax management. There are three key considerations to weigh before December 31 that create tax alpha in a portfolio. It may go without saying, but tax-related selling is relevant only for taxable accounts. In other words, 401k plans, traditional IRAs, interest on municipal bond funds (but not any capital gains on those bonds) are tax-free on the federal level.

## Three ways to create tax alpha:

1. **Defer certain buys—don't buy a mutual fund in the days or weeks before a significant year-end distribution.**

   Relatively large fourth quarter distributions are common for mutual funds, particularly in a year of strong performance like this one. Avoid making a purchase of a mutual fund that will pay out a large distribution ahead of the "record" date. Why? Collect the distribution and it comes with all of the tax consequences related to that distribution earned over the whole year, when you did not own it! Here are the key dates to know:

   - **Record date:** Owners of the fund as of the record date are the ones who receive the distributions. P*urchasing a fund on or ahead of this date means you will get the distribution, and triggers the tax consequences of the distributions.*
   - **Ex-dividend date:** This is always the next trading day after the record date.  All else equal, the NAV of the mutual fund declines by the amount of the distribution in order to reflect the amount paid out.

> *"The hardest thing in the world to understand is the income tax"*
>
> *— Albert Einstein*

**Sierra Mutual Funds**
3420 Ocean Park Boulevard
Suite 3060
Santa Monica, CA 90405

National Sales Desk
844 | 727-1813

Shareholder Services
866 | 738-4363

**2. Sell (or don't sell) funds with losses or limited gains ahead of annual distributions**

If the percentage gain earned on a mutual fund above cost (original cost) is less than this year's annual distribution as a percentage of Net Asset Value, or NAV, sell the position before the record date. Why? The tax triggered from the sale will be less than what it would be if the distribution is collected. If the taxable gain earned is greater than the distribution that will be paid, don't sell.

**3. Harvest losses before year end—sell to take losses which can be used to offset taxable gains.**

Losing money is never a good thing, but it can be made less painful because those losses can offset capital gains through tax-loss harvesting. For any holding that is worth less than your purchase price, sell on or before December 29 this year. Apply as much of a loss as possible to short-term gains (they are taxed at a high marginal rate).

Unused losses can be carried forward to use in future years. Beware:

- "Wash sales" occur when a security is sold at a loss and then it or something "substantially identical" is re-purchased within 30 calendar days (not trading days). Under IRS rules, the tax benefit of the loss will be suspended until the re-acquired shares are sold. The easy solution is to wait 31 days to re-purchase.
- Qualified dividends (which are taxed at a lower rate than ordinary dividends) held less than 61 days are taxed as ordinary income rates.
- Selling a mutual fund that pays tax-exempt income (such as a municipal bond fund) reduces the harvested loss dollar for dollar by the interest, if that fund is held less than six months.



9586-NLD-12/7/2017