



ADVISER FUND UPDATE

Market Summary and Commentary for Individual Investors from Adviser Investments



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New Wrinkle for Year-End Tax Planning

Tax moves for tax-year 2012 are complicated by the as of yet unresolved fiscal cliff issue. No one can know how taxes, particularly capital gains taxes, are going to change in the coming year. Many are making the assumption that they will go up, but the question of how much is still up in the air, and it's difficult to chart a course based on what you fear may happen but don't know will happen.

If you make assumptions about future returns in your investments and the rate at which gains will be taxed, you can estimate how long you'd have to hold on to a fund with long-term gains to be better off than paying 2012 long-term capital gains rates (15%). And on the flip side of that coin, it may also be more valuable to hold onto losses until next year to offset gains at higher rates.

What follows is a quick guide to our standard approach to year-end tax planning, but bear in mind that you may want to factor the fiscal cliff wrinkle into your personal accounting.

Turn Losses into Relief

While we caution against letting the "tax tail wag the portfolio dog," you may want to consider taking advantage of the opportunity to trim your taxes by "harvesting" tax losses on mutual funds you own in taxable accounts. (If you own your funds in tax-advantaged accounts, such as IRAs, there is no need to worry about tax-loss harvesting.)

By harvesting, we're referring to offsetting any capital gains you incurred in 2012 by selling funds (or particular share lots) that have lost value since your original purchase. Short-term gains are subject to ordinary income tax rates, which can be as high as 35%--and may be heading higher. Losses can also be used to offset ordinary income, but only up to \$3,000 per year. Any losses not used this year can be carried forward to future years.

As you consider your tax-planning options, however, be aware of the wash-sale rule. This rule is designed to prevent investors from temporarily selling shares to gain a tax advantage and then repurchasing them a short time later.

- [New Wrinkle for Year-End Planning](#)

Under the wash-sale rule, you lose the ability to claim a tax loss if you make a purchase of the same fund (or a substantially similar fund) 30 days prior to or 30 days after a sale. Therefore, if you sold 100 shares of XYZ fund on December 15 at a loss and bought the shares back on January 3, 2012, you could not claim a capital loss. The same rule would apply if you bought shares on November 15 and sold them on December 12. These rules apply whether you made a direct purchase or reinvested a fund distribution.

Assuming you abide by the wash-sale rule, harvesting tax losses can be a cost-saving aspect of your investment strategy. You should also be careful not to sell shares of a fund you won't be able to replace. For example, if a fund is closed to new investors and you sell all of your shares, you won't be able to buy back in.

As always when it comes to tax planning, our best advice is to speak to a trusted professional tax advisor--especially this year, with the potential for higher taxes looming--to help you come up with a course of action that works best for you.

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