

## OAKLAND BUSINESS &amp; Finance

## Understand formula for mutual fund distribution

## MORE THAN MONEY

SID MITTRA  
Ph.D.

A mutual fund distribution can comprise net capital gains realized from the sale of a fund's investments and income from dividends and interest earned by a fund's holdings. By law, mutual funds must pay all net capital gains, dividends, and interest to their investors, who may elect to receive cash or reinvest in additional shares of the fund.

## The Distribution

A mutual fund generates capital gains and income for shareholders in two ways — by selling investments that have increased

in price and by earning dividends and interest on its investments.

There are two kinds of distributions. Capital gains distributions are the net long-term gains realized from the sale of fund securities. For tax purposes, capital gains distributions represent net long-term gains from selling securities held more than a year and are taxed at the capital gains tax rates. This applies to capital gains paid by both taxable and tax-free funds.

Income distributions from taxable funds represent dividends or interest the fund earns on its investments and from net short-term gains (securities held one year or less). Income distributions from tax-free funds represent short-term capital gains and market discount from the sale of securities. These are taxed at the

shareholder's ordinary income tax rate. Distributions of coupon payments on municipal bonds, of course, are free of federal income tax.

Incidentally, distributions do not correlate with a fund's total return. For example, a fund could have a negative total return, but still would be required to make a distribution. The opposite situation could also prevail. Another interesting tax issue: Capital gains distributions taken in cash, but not those taken in shares, are subject to Michigan intangibles tax.

## Timing of Distributions

Money market and bond funds generally declare dividends daily and distribute income dividends monthly. Equity funds distribute capital gains and dividends ac-

cording to the funds' fiscal years described in each fund's prospectus. Capital gains generally are paid at fiscal year-end and calendar year-end. Dividends are often paid quarterly for growth and income funds, and annually at fiscal year-end and calendar year-end for growth funds.

## Distribution and Share Price

Capital gains and dividend distributions cause the fund's net asset value (NAV) per share to decrease by the amount of the distribution, except in the case of example, if a fund planned to pay a distribution of \$5 per share and the fund's NAV was \$70 per share, other factors remaining the same, after the distribution the NAV would be \$65 per share.

## Distributions and Taxes

Shareholders are responsible for paying applicable taxes on distributions on an annual basis, whether they receive the distributions in cash or reinvest them in additional shares of the fund. Income distributions derived from tax-exempt interest from tax-free funds are exempt from federal income taxes but other income and

capital gains distributions are not. Individual Retirement Accounts (IRAs) are not currently taxed on capital gains or income distributions.

Sid Mittra, Ph.D., CFP, is professor of finance, Oakland University, Rochester Hills, and owner, Mittra & Associates, a Troy financial consulting firm.

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This column highlights promotions, transfers, hirings, openings and other key business news with Farmington-area connections. Send a brief biographical summa-

ry — including the towns of residency and employment and a photo, if possible, to: Business Editor, Farmington Observer, 33411 Grand River, Farmington

48335. The Observer's fax number is (810) 477-9722.

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See MILESTONES, 8A

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