THE DEFINITIVE GUIDE TO ETF TAXATION

2015 Edition

TABLE OF CONTENTS

ETF.com

INTRODUCTION ... 3
What Drives ETF Taxation ... 3

EQUITY AND FIXED INCOME ... 4
Taxation of Regulated Investment Companies (RIC) ... 4

COMMODITY ETFs ... 6
Commodity Grantor Trusts ... 6
Commodity Limited Partnerships ... 6
Commodity ETNs ... 7
Commodity Open-ended Funds ... 7

CURRENCY ETFs ... 8
Currency Open-ended Funds ... 8
Currency Grantor Trusts ... 8
Currency Limited Partnerships ... 8
Currency ETNs ... 9

ALTERNATIVE ETFs ... 10

TAXATION OF DISTRIBUTIONS ... 11
Equity ETFs ... 11
Currency-Hedged Equity ETFs ... 11
Fixed Income ETFs ... 12
Commodity ETFs ... 12
Currency ETFs ... 12
Return of Capital Distributions ... 12
MLP ETFs ... 13
BuyWrite ETFs ... 13
Tying it all Together ... 14

2013 CAPITAL GAINS TAX CHANGES ... 15
Medicare Surcharge Tax ... 15

TAX TABLES ... 16

INTRODUCTION

Investors spend hours researching funds for expense ratios and spreads, trying to save a few basis points here and there. But often, not enough time is spent researching a fund's structure and the associated tax implications.

Based on how the ETF's distributions are taxed and the taxation of gains when shares are eventually sold, the different tax implications can translate into hundreds or even thousands of basis points.

Investor confusion over tax treatments comes from many sources. Partly, it's because ETF taxation is complicated. Partly, it's because taxes are boring. And partly, it's because ETF issuers provide unclear tax guidance in many prospectuses.

Whatever the reason, we at ETF.com think investors deserve better, so we prepared this document to provide complete guidance on how different ETFs are treated by the tax man.

WHAT DRIVES ETF TAXATION

An ETF's taxation is ultimately driven by its underlying holdings. Since funds are structured differently according to how they gain exposure to the underlying asset, an exchange-traded product's tax treatment inherently depends on both the asset class it covers and its particular structure.

A fund's asset class can be classified in one of five categories: equities; fixed income; commodities; currencies; and alternatives.

For tax purposes, exchange-traded products come in one of five structures: open-end funds; unit investment trusts (UITs); grantor trusts; limited partnerships (LPs); and exchange-traded notes (ETNs).

Many commodity and currency funds that hold futures contracts are regulated by the Commodity Futures Trading Commission (CFTC) as commodities pools, but they're classified as limited partnerships for tax purposes by the IRS. Therefore, "limited partnership" will be used to refer to the structure of these funds throughout this paper.

This five-by-five matrix—five asset classes and five fund structures—defines all the potential tax treatments available in the ETF space. In this paper, we'll use asset class as the primary sort, as that is the easiest way to classify and think about funds.

Note: The tax rates we're about to discuss are the maximum long-term and short-term capital gains rates. The rates listed in the tables for each respective asset classes do not include the Medicare surcharge tax of 3.8 percent applicable to certain investors. Long-term capital gains apply to positions held for longer than one year; short-term capital gains apply to positions held for one year or less.

EQUITY AND FIXED INCOME

Equity and fixed-income ETFs currently operate in three different structures: open-end funds, unit investment trust (UITs) or ETNs.

Most all equity and fixed-income ETFs are structured as open-ended ETFs. Examples of open-end funds include the iShares EFA ETF (EFA), Vanguard FTSE Emerging Markets Index ETF (VWO) and the iShares Barclays TIPS Bond Fund (TIP).

MAXIMUM CAP GAINS TAX RATE

STRUCTURE	LONG-TERM	SHORT-TERM
Open End (40 Act)	20.00%	39.60%
UIT (40 Act)	20.00%	39.60%
Grantor Trust (33 Act)	N/A	N/A
Limited Partnership (33 Act)	N/A	N/A
ETN (33 Act)	20.00%	39.60%

Still, there are a handful of funds structured as UITs. Some of the first ETFs on the market were structured as such, and include the SPDR S&P 500 Fund (SPY), the PowerShares Nasdaq 100 ETF (QQQ) and the SPDR Dow Jones Industrial ETF (DIA).

There are some peculiarities associated with UITs which investors should understand. First, UITs must fully replicate their indexes (as opposed to optimizing their portfolios). UITs also cannot reinvest dividends from their holdings back into the trust the way open-ended funds can, which creates some “cash drag” in these specific products.

Then there are a select few ETNs, such as the iPath MSCI India Index ETN (INP) and ETRACS Wells Fargo Business Development Company ETN (BDCS).

Fortunately, all three structures receive the same tax treatment: The long-term capital gains rate is 20 percent if shares are held for more than one year; if shares are held for one year or less, gains are taxed as ordinary income—with a maximum rate of 39.60 percent.

TAXATION OF REGULATED INVESTMENT COMPANIES (RIC)

You have probably noticed that a single position in most ETFs never exceeds 25 percent of its total weighting. Or for that matter, you may have noticed that a fund tracks a “25/50” index. This is because an ETF has to abide by certain diversification rules to qualify as a Regulated Investment Company (RIC) under Regulation M in the eyes of the IRS.

While there are many requirements to qualify as a RIC, one of those requirements addresses diversification: a single holding in a RIC cannot exceed 25%, and the aggregate of all positions over 5% cannot exceed 50% of the fund’s total weighting.

It’s important to stay RIC-compliant to avoid double taxation. If an ETF isn’t taxed as a RIC, it gets taxed on its dividends and gains from its’ holdings like a corporation, and the investor gets taxed again on their distributions.

For the fund to avoid being taxed at the fund level, it must distribute all of its taxable income from dividends, as well as any net capital gains to its shareholders. In doing so and qualifying as a RIC, the fund is eligible to pass on gains to its shareholders directly without paying taxes itself.

Two Notable Exceptions:

Most ETFs tracking the Master Limited Partnership market (MLPs) are structured as open-ended funds, but classified by the IRS as C-corporations for taxation purposes. While the taxation of gains from selling fund shares is the same as for other equity ETFs, the distribution of these products is complex, and highlighted under MLP ETFs in the "Taxation of Distributions" section.

The PowerShares China A-shares ETF (CHNA) is currently the only equity ETF that is regulated by the CFTC as a commodities pool, but structured as an open-ended fund. CNHA holds a futures contract traded in Singapore that is tied to the FTSE China A50 index. Since CHNA holds an equity-linked futures contract, the taxation of gains on share sales is similar to the way other equity ETFs are taxed.

COMMODITY ETFs

Commodity ETFs generally come in one of three structures: grantor trusts; limited partnerships; or ETNs. In recent months, issuers have begun launching open-ended commodity ETFs that utilize subsidiaries in the Cayman Islands, which allows them to bypass K-1 forms for tax reporting purposes.

Knowing the structure of commodity funds is crucial, since the tax implications differ dramatically between the various structures.

MAXIMUM CAP GAINS TAX RATE

STRUCTURE	LONG-TERM	SHORT-TERM
Open End (40 Act)	20.00%	39.60%
UIT (40 Act)	N/A	N/A
Grantor Trust (33 Act)	28.00%	39.60%
Limited Partnership (33 Act)*	27.84%**	27.84%**
ETN (33 Act)	20.00%	39.60%

*Distributes K-1 **Max rate of blended 60% LT/40% ST

COMMODITY GRANTOR TRUSTS

Grantor trust structures are used for "physically held" precious metals ETFs, such as the SPDR Gold Shares (GLD), the iShares Gold Trust (IAU) and the iShares Silver Trust (SLV). These and related funds store the physical commodity in question in vaults, giving investors direct exposure to spot returns.

Under current IRS rules, investments in these precious metals ETFs are considered collectibles. Collectibles never qualify for the 20 percent long-term tax rate applied to traditional equity investments; instead, long-term gains are taxed at a maximum rate of 28 percent. If shares are held for one year or less, gains are taxed as ordinary income, again at a maximum rate of 39.60 percent.

There's a growing consensus that the wash sale rule does not apply to collectibles. If the wash sale rule were to not apply to commodity grantor trusts, then it means investors can literally sell one product like GLD to realize their losses, then immediately jump right back into a practically identical ETF like IAU (which also happens to be 15 basis points less in expenses than GLD).

That said, there's no direct ruling from the IRS at the moment regarding commodity grantor trust ETFs and the wash sale rule, so a discussion with a tax professional is advised regarding this issue.

COMMODITY LIMITED PARTNERSHIPS

Many ETFs hold futures contracts to gain exposure to commodities and are structured as limited partnerships, or LPs.

Some commodity funds structured as LPs include the PowerShares DB Commodity Index Tracking Fund (DBC), the United States Natural Gas Fund (UNG) and the iShares S&P GSCI Commodity-Indexed Trust (GSG). There are even ETFs that invest in precious metals futures, which stand in contrast to the physically backed funds mentioned earlier.

Futures-based funds have unique tax implications. Currently, 60 percent of any gains are taxed at the long-term capital gains rate of 20 percent, and the remaining 40 percent is taxed at the investor's ordinary income rate, regardless of how long the shares are held. This comes out to a blended maximum capital gains rate of 27.84 percent.

Limited partnership ETFs are considered pass-through investments, so any gains made by the trust are "marked to market" at the end of each year and passed on to its investors, potentially creating a taxable event. This means that

your cost basis adjusts at year-end and you can be subject to pay taxes on gains regardless of whether you sold your shares or not.

For tax reporting, limited partnership ETFs also generate a Schedule K-1 form. This can create uncertainty and annoyance for the average investor not familiar with K-1s when they receive these forms in the mail.

COMMODITY EXCHANGE-TRADED NOTES

Commodity ETNs do not hold the physical commodity, nor do they hold futures contracts. They are unsubordinated, unsecured debt notes issued by banks that promise to provide the return of a specific index. Therefore, commodity ETNs carry credit risk: If the bank issuing the note goes bankrupt or defaults, investors can lose their entire investment.

Popular commodity ETNs include the iPath Dow Jones-UBS Commodity Index Total Return ETN (DJP), the Elements Rogers International Commodity Total Return ETN (RJI) and the iPath S&P GSCI Crude Oil Total Return Index ETN (OIL).

Commodity ETNs are currently taxed like equity and/or bond funds. Long-term gains are taxed at 20 percent, while short-term gains are taxed as ordinary income (maximum 39.60 percent). Despite the fact that many of these products track futures-based indexes, they do not generate a K-1.

COMMODITY OPEN-ENDED FUNDS

Open-ended commodity ETFs are a newer structure for this asset class and considered to be "next-generation" funds that aren't required to distribute K-1 forms for tax reporting purposes.

Open-ended commodity ETFs gain exposure futures contracts through a subsidiary in the Cayman Islands. The subsidiary, as opposed to the fund itself, invests in futures contracts.

The ETF limits its weighting in the subsidiary to 25 percent, thereby staying RIC-compliant for taxation purposes. It usually parks its cash collateral in Treasury-bills. This unique structure allows these funds to access futures contracts without having to distribute K-1 forms to its shareholders.

Even though these funds bypass K-1s, since they're '40 Act funds, any gains made in the futures contracts are likely to be distributed to its shareholders at year-end. Furthermore, those gains are likely to be taxed as ordinary income, as opposed to the blended "60/40" rate that futures contracts normally get.

Launched in October 2013, the First Trust Global Tactical Commodity Strategy Fund (FTGC) was the first futures contract-based commodity ETF structured as an open-ended fund. Since then, we've seen more launches, including the PowerShares DB Optimum Yield Diversified Commodity Strategy ETF (PDBC) and the iShares Commodity Strategy ETF (COMT).*

*We classify COMT as an asset allocation ETF, since it combines futures contracts and equities to gain broad exposure to commodities.

CURRENCY ETFs

Currency ETFs come in one of four structures: open-end funds; grantor trusts; limited partnerships; or ETNs.

MAXIMUM CAP GAINS TAX RATE

STRUCTURE	LONG-TERM	SHORT-TERM
Open End (40 Act)	20.00%	39.60%
UIT (40 Act)	N/A	N/A
Grantor Trust (33 Act)	39.60%	39.60%
Limited Partnership (33 Act)*	27.84%**	27.84%**
ETN (33 Act)	39.60%	39.60%

*Distributes K-1 **Max rate of blended 60% LT/40% ST

CURRENCY OPEN-ENDED FUNDS

WisdomTree and PIMCO are currently the only issuers to offer currency ETFs structured as open-end funds. Some popular open-ended currency funds include the WisdomTree Dreyfus Chinese Yuan Fund (CYB), the WisdomTree Dreyfus Brazilian Real Fund (BZF), the PIMCO Foreign Currency ETF (FORX) and the WisdomTree US Dollar Bullish Fund (USDU).

Open-ended currency funds do not hold currency notes or futures contracts. Instead, they mostly hold the bulk of their assets in U.S. Treasury bills and repurchase agreements (repos), while gaining exposure to the reference currencies through forward currency contracts (and sometimes swaps).

Tax implications for these funds are similar to equity funds. When shares are sold, gains are taxed as long-term capital gains (20 percent) if held for more than one year; if held for one year or less, gains are taxed as ordinary income (maximum 39.60 percent).

That said, most of the funds' gains from its forward currency contracts (its actual exposure to the targeted currency) get distributed out to its shareholders quarterly or annually, and those distributions are generally taxed at the same blended rates that futures contracts are taxed at (See Currency ETFs in Taxation of Distributions section).

CURRENCY GRANTOR TRUSTS

CurrencyShares are structured as grantor trusts. Each CurrencyShares product gives investors exposure to spot exchange rates of the underlying currency by holding the foreign currency in bank accounts. The most popular CurrencyShares are currently the Canadian Dollar Trust (FXC), the Swiss Franc Trust (FXF) and the Australian Dollar Trust (FXA).

The taxation of CurrencyShares products is straightforward. All gains from the sale of shares are taxed as ordinary income (maximum 39.60 percent), regardless of how long they're held by the investor.

CURRENCY LIMITED PARTNERSHIPS

Similar to commodity LP funds, currency funds that hold futures contracts are structured as LPs. These funds include the PowerShares DB US Dollar Index Bearish and Bullish Funds (UDN and UUP, respectively) as well as leveraged currency funds such as the ProShares UltraShort Euro Fund (EUO) and the ProShares UltraShort Yen Fund (YCS).

The tax implications for currency limited partnership ETFs are the same as commodity limited partnership ETFs—gains are subject to the same 60 percent/40 percent blend, regardless of how long the shares are held. They're also marked to market at year-end and are reported on K-1s.

CURRENCY EXCHANGE-TRADED NOTES

Some uncertainty surrounds the taxation of currency ETNs. Due to an IRS ruling in late 2007—Revenue Ruling 2008-1—gains from currency ETNs are now generally taxed as ordinary income (maximum 39.60 percent), regardless of how long the shares are held by the investor.

However, according to the prospectuses of some currency ETNs, investors might have an option to classify gains as long-term capital gains if a valid election under Section 988 is made before the end of the day that the ETN was purchased.

As with all ETNs, not only do currency ETNs carry counterparty risk, but the entire value of the note is dependent on the credit of the issuing bank.

Some currency ETPs structured as exchange-traded notes include the Market Vectors Chinese Renminbi/USD ETN (CNY), the iPath EUR/USD Exchange Rate ETN (ERO) and the PowerShares DB 3X Long US Dollar Index ETN (UUPT).

ALTERNATIVE ETFs

ETF.com

Alternative funds seek to provide diversification by combining asset classes or investing in nontraditional assets, and generally come in one of three structures: open-end funds; limited partnerships; or ETNs.

The construction of many alternative ETFs can be complicated, but the taxation of gains made from selling shares in the funds fall in line with their respective structures.

MAXIMUM CAP GAINS TAX RATE

STRUCTURE	LONG-TERM	SHORT-TERM
Open End (40 Act)	20.00%	39.60%
UIT (40 Act)	N/A	N/A
Grantor Trust (33 Act)	N/A	N/A
Limited Partnership (33 Act)*	27.84%**	27.84%**
ETN (33 Act)	20.00%	39.60%

*Distributes K-1 **Max rate of blended 60% LT/40% ST

Managed-futures funds like the WisdomTree Managed Futures Strategy Fund (WDTI) hold futures contracts in a subsidiary in the Cayman Islands. These funds limit the weighting to its subsidiary to 25 percent, making them RIC-compliant. Since it's structured as an open-ended fund, gains are taxed the way most equity ETFs are taxed.

While the taxation of distributions of buywrite ETFs like the PowerShares S&P 500 BuyWrite ETF (PBP) are complex, gains made from selling shares are taxed just like other equity funds (See BuyWrite ETFs under Taxation of Distributions section).

Alternative funds that hold futures contracts directly like some volatility, commodity and currency funds are structured as LPs and taxed as such. All gains are taxed at the blended 60 percent/40 percent rate, regardless of holding period, creating a maximum blended tax rate of 27.84 percent. Examples include the PowerShares DB G10 Currency Harvest Fund (DBV) and the ProShares VIX Short-Term Futures Fund (VIXY).

Finally, alternative funds structured as ETNs currently have the same tax implications on gains from share sales as other equity ETNs.

One Notable Exception

The iPath Optimized Currency Carry ETN (ICI) is an exception to the rule regarding alternative ETNs. ICI is considered a currency ETN for tax purposes, with gains from sales that generally get taxed as ordinary income regardless of how long shares are held.

TAXATION OF DISTRIBUTIONS

Besides taxes on capital gains incurred from selling shares of ETFs, investors also pay taxes on periodic distributions paid out to shareholders throughout the year. These distributions can be from dividends paid out from the underlying stock holdings, interest from bond holdings, return of capital (ROC) or capital gains—which come in two forms: long-term gains and short-term gains. The good news is that most of the time, this will be indicated directly on any 1099's received. Still, for planning purposes, it's important to know what you can expect.

Distributions from ETFs are usually paid out monthly, quarterly, semiannually or annually.

EQUITY ETFs

Most equity ETFs hold companies that pay dividends in their portfolios. There are two kinds of dividends that investors should be aware of: qualified dividends and nonqualified dividends.

Qualified dividends are dividends paid out from a U.S. company whose shares have been held for more than 60 days during the 121-day period that begins 60 days before the ex-dividend date. Importantly, this refers to the shares held by the ETF itself, and not the holding period of investors in the ETF.

Qualified dividends are taxed at a maximum rate of 20 percent, compared with nonqualified dividends, which are taxed as ordinary income. Many of the dividends paid out to shareholders in domestic equity ETFs are qualified dividends.

REITs fall into their own category when it comes to the taxation of its distributions. Generally, distributions from REITs are all taxed as ordinary income, so for investors in many equity real estate ETFs dominated by REITs, much of your distributions are likely to be taxed like ordinary income rather than qualified dividends.

Equity ETNs don't hold any securities, but generally track total return indexes. These indexes capitalize all distributions back in the index.

CURRENCY-HEDGED EQUITY ETFs

Currency hedged equity ETFs deserve their own section because the taxation of distributions from these funds are often confusing for many investors.

Currency hedged ETFs overlay their equity positions with monthly "short" currency contracts to neutralize the inherent long currency exposure of its equity holdings. In years when the underlying currency depreciates rapidly against the US dollar, the funds can realize gains from those contracts.

For example, in 2014, many currency-hedged Japan ETFs were forced to pay out enormous distributions at year end, some upwards of 8-9% of their respective NAVs. Those distributions were mostly from gains made in the forward currency contract positions due to the plunge in the yen in late 2014.

Complicating the matter, the distributions from forward contract gains were taxed differently in 2014 between the two leading issuers with currency hedged products: WisdomTree and Deutsche X-trackers.

WisdomTree's distributions from forward contract gains were taxed at the blended "60/40" rate, similar to the way futures contracts are taxed, while distributions from Deutsche X-trackers' forward contract gains were taxed as ordinary income.

FIXED INCOME ETFs

Investors should keep in mind that while monthly distributions from bond ETFs are often called "dividends," interest from the underlying bond holdings aren't considered qualified dividends and are taxed as ordinary income.

COMMODITY ETFs

Commodity funds structured as limited partnerships and open-ended funds rarely pay out distributions throughout the year. But some of them park their cash collateral in US Treasury Bills, so at times can pay out interest distributions from those holdings. Those distributions are taxed as ordinary income.

For details on how gains from futures contracts in limited partnerships and open-ended funds are distributed or taxed, see our "Commodity ETFs" section.

CURRENCY ETFs

Distributions are often a large component of currencies, so it pays to understand the ins and outs of currency ETF distributions, as they can be tricky.

CurrencyShares products structured as grantor trusts distribute the interest accrued from its underlying currency holdings. Those are paid out month and taxed as ordinary income.

Some currency ETFs structured as open-ended funds, such as WisdomTree's products, pay out distributions from its holdings in Treasury Bills and from gains made in its forward currency contracts. Distributions from its T-bill holdings are taxed as ordinary income, while distributions from gains made in forward contracts is generally taxed the way futures are taxed: the "60/40" blended long-term and short-term rate.

Most currency ETNs don't pay out any distributions to its shareholders. But if they do, distributions are taxed as ordinary income. Also, if a note generates any income that's not distributed throughout the year, investors can still be subject to pay taxes on this "phantom income" at year end, making currency ETNs particularly tax ineffective.

RETURN OF CAPITAL DISTRIBUTIONS

While the vast majority of ETFs make simple distributions, funds can also pay out distributions in excess of the fund's earnings and profits called return of capital (ROC). ROC distribuitions are generally nontaxable and reduces the investor's cost basis by the amount of the distribution. While any fund can theoretically make ROC distributions, it's common in master limited partnership funds, such as the Alerian Master Limited Partnership Fund (AMLP).

MLP ETFs

The taxation of MLP ETF distributions is complex. Most MLP ETFs are structured as open-ended funds, but classified by the IRS as C-corporations for taxation purposes. For these types of funds, most of their distributions are ROC, which is not a taxable event, but lowers your cost basis by the amount of the distribution at year end.

There are also a handful of MLP funds structured as open-ended funds that are not classified as C-corporations by the IRS and are instead taxed like RICs. These funds mostly hold energy infrastructure companies, and contain their exposure to actual MLPs to under 25 percent. Distributions from these ETFs are generally a mixture of qualified dividends and ROC.

MLP ETNs are much simpler. Distributions from them are all taxed as ordinary income.

The great part about MLP ETFs is that regardless of their structures, investors don't have to deal with K-1 forms, since tax reporting is done on 1099s.

It's worth acknowledging that this is a significant oversimplification of everything that goes on "under the hood" of a modern MLP ETF from a tax perspective, and those who want to do a deeper dive into the complexities around the tax implications of MLP ETFs, see our whitepaper, The Definitive Guide to MLP ETFs and ETNs.

BUYWRITE ETFs

The taxation of distributions from BuyWrite ETFs is a subject of deep confusion for many investors. That's because the taxation of covered call strategies is a complex matter that could make even a tax advisor's head spin.

Generally, most distributions from BuyWrite ETFs and gains made from the covered call strategies are taxed at short term capital gains rates. Still, it's important to differentiate between stock options and index options, as their tax implications are different.

Some ETFs, including the PowerShares S&P 500 BuyWrite ETF (PBP), overlay their stock holdings with an index option. Index options generally are taxed the way futures contracts are taxed—the 60/40 blended rate.

Other BuyWrite ETFs, such as the Horizons S&P 500 Covered Call ETF (HSPX), write stock options on each individual holding. Complicating the matter, the taxation of gains can vary depending on whether the covered call strategy is considered "qualified" or "unqualified."

(In order to be considered a qualified covered call, the option must be at-the-money or out-of –the-money, with 30 or more days till expiration.)

Furthermore, tax implications can differ once again depending on if the strategy is deemed to be a "straddle" which certain BuyWrite ETFs fall under.

The taxation of covered call strategies is highly complex, so we strongly advise consulting a tax advisor for tax details regarding the distributions around these products. Alternatively, investors can limit their use to non-taxable accounts.

TYING IT ALL TOGETHER

Fortunately for investors, all the various distributions are broken down in the 1099-DIV at year-end. The 1099-DIV will first show "Total Ordinary Dividends," which includes both qualified and nonqualified dividends, as well as any short-term capital gains. Qualified dividends that are subject to the beneficial 20 percent tax rate are further separated under the "Qualified Dividends" heading.

Any long-term capital gains that qualify for the 20 percent rate are separated as well, listed under the heading "Total Capital Gains Distributions." ROC distributions should be included in the "Nondividend Distributions" section on the 1099-DIV.

Effective Jan. 1, 2013, due to the passing of the American Taxpayer Relief Act of 2012, singles with a taxable income over $400,000 and married filing jointly with taxable income over $450,000 are now subject to higher capital-gains tax rates.

For investors in this higher tax bracket, long-term capital gains rates have increased from 15 to 20 percent, while short-term capital-gains rates increased from 35 to 39.6 percent. Qualified dividends are also now taxed at this new 20 percent rate, while interest income from bond funds will continue to be subject to ordinary income rates, or a maximum of 39.60 percent.

For all other filers with a taxable income equal to or less than the $400,000/$450,000 threshold, all rates on capital gains and qualified dividends remain the same as in 2012 (excluding the Medicare tax, which is a separate tax with a different income threshold), with maximum long-term capital gains and qualified dividends still taxed at a 15 percent rate, and maximum short-term rates taxed at 35 percent.

MEDICARE SURCHARGE TAX

Effective Jan. 1, 2013, due to the passing of the Patient Protection and Affordable Care Act, singles with an adjusted gross income (AGI) over $200,000 and married filing jointly with an AGI over $250,000 are now subject to an additional 3.8 percent Medicare surcharge tax on investment income, which includes all capital gains, interest and dividends.

This new tax will be levied on the lesser of net investment income or modified adjusted gross income (MAGI) in excess of $200,000 single/$250,000 joint. Therefore, for investors in the highest tax brackets, their "true" tax rates on long-term capital gains and qualified dividends can reach 23.8 percent (20 percent capital gains plus 3.8 percent Medicare tax).

Disclaimer

We are not professional tax advisors. This article is for informational purposes only and not intended to be tax advice. Tax rules can change. Individuals should always consult with a professional tax advisor for details about the tax implications of investment products and their personal taxes.

2013 CAPITAL GAINS TAX CHANGES

Effective Jan. 1, 2013, due to the passing of the American Taxpayer Relief Act of 2012, singles with a taxable income over $400,000 and married filing jointly with taxable income over $450,000 are now subject to higher capital-gains tax rates.

For investors in this higher tax bracket, long-term capital gains rates have increased from 15 to 20 percent, while short-term capital-gains rates increased from 35 to 39.6 percent. Qualified dividends are also now taxed at this new 20 percent rate, while interest income from bond funds will continue to be subject to ordinary income rates, or a maximum of 39.60 percent.

For all other filers with a taxable income equal to or less than the $400,000/$450,000 threshold, all rates on capital gains and qualified dividends remain the same as in 2012 (excluding the Medicare tax, which is a separate tax with a different income threshold), with maximum long-term capital gains and qualified dividends still taxed at a 15 percent rate, and maximum short-term rates taxed at 35 percent.

MEDICARE SURCHARGE TAX

Effective Jan. 1, 2013, due to the passing of the Patient Protection and Affordable Care Act, singles with an adjusted gross income (AGI) over $200,000 and married filing jointly with an AGI over $250,000 are now subject to an additional 3.8 percent Medicare surcharge tax on investment income, which includes all capital gains, interest and dividends.

This new tax will be levied on the lesser of net investment income or modified adjusted gross income (MAGI) in excess of $200,000 single/$250,000 joint. Therefore, for investors in the highest tax brackets, their “true” tax rates on long-term capital gains and qualified dividends can reach 23.8 percent (20 percent capital gains plus 3.8 percent Medicare tax).

ETF.com

MAX LT/ST CAPITAL GAINS RATES (TAXABLE INCOME EQUAL TO OR LESS THAN $400K SINGLE/$450K JOINT)

STRUCTURE	EQUITY & FIXED INCOME	COMMODITY	CURRENCY	ALTERNATIVE
Open End (40's Act)	15/35	15/35	15/35	15/35
UIT (40's Act)	15/35	N/A	N/A	N/A
Grantor Trust (33 Act)	N/A	28/35	35/35	N/A
Limited Partnership (33 Act)	N/A	23/23*	23/23*	23/23*
ETN (33 Act)	15/35	15/35	35/35	15/35

*Max blended rate of 60% LT/40% ST

NOTE: These rates are NOT inclusive of the 3.8% Medicare surcharge tax or any additional taxes applicable from the phaseout of itemized deductions and personal exemptions.

MAX LT/ST CAPITAL GAINS RATES (TAXABLE INCOME EQUAL TO OR LESS THAN $400K SINGLE/$450K JOINT)

STRUCTURE	EQUITY & FIXED INCOME	COMMODITY	CURRENCY	ALTERNATIVE
Open End (40's Act)	20/39.60	20/39.60	20/39.60	20/39.60
UIT (40's Act)	20/39.60	N/A	N/A	N/A
Grantor Trust (33 Act)	N/A	28/39.60	39.60/39.60	N/A
Limited Partnership (33 Act)	N/A	27.84/27.84*	27.84/27.84*	27.84/27.84*
ETN (33 Act)	20/39.60	20/39.60	39.60/39.60	20/39.60

*Max blended rate of 60% LT/40% ST

NOTE: These rates are NOT inclusive of the 3.8% Medicare surcharge tax or any additional taxes applicable from the phaseout of itemized deductions and personal exemptions.

Disclaimer

We are not professional tax advisors. This article is for informational purposes only and not intended to be tax advice. Tax rules can change. Individuals should always consult with a professional tax advisor for details about the tax implications of investment products and their personal taxes.