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. When shares are eventually sold for a gain, 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 IndexUniverse 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 relevant through the end of 2012. Starting 2013, tax rates are scheduled to change. Long-term gains apply to positions held for longer than one year; short-term gains apply to positions held for one year or less.

EQUITY AND FIXED-INCOME FUNDS
Equity and fixed-income ETFs currently operate in four different structures: open-end funds, UITs, grantor trusts or ETNs.

Examples of open-end funds include the Vanguard MSCI Emerging Markets ETF (VWO) and iShares Barclays TIPS Bond Fund (TIP). An example of a UIT is the SPDR S&P 500 ETF (SPY). HOLDRS are the only grantor trusts in the equity space, while the iPath MSCI India Index ETN (INP) is an example of an equity ETN.

Fortunately, all four receive the same tax treatment: The long-term capital gains rate is 15% 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 35%.
COMMODITY FUNDS

Commodity ETPs come in one of three structures: grantor trusts, limited partnerships or ETNs. Knowing the structure of commodity funds is crucial, since the tax implications differ dramatically between the various structures.

Commodity Grantor Trusts

Grantor trust structures are used for “physically held” precious metals ETFs, such as the SPDR Gold Shares (GLD), iShares Silver Trust (SLV) and ETFS Physical Swiss Gold Shares (SGOL). 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 15% long-term tax rate applied to traditional equity investments; instead, long-term gains are taxed at a maximum rate of 28%. If shares are held for one year or less, gains are taxed as ordinary income, again at a maximum rate of 35%.

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), United States Natural Gas Fund (UNG) and 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% of any gains are taxed at the long-term capital gains rate of 15%, and the remaining 40% 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 23%.

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. This means they 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), Elements Rogers International Commodity Total Return ETN (RJI) and 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 15%, while short-term gains are taxed as ordinary income (maximum 35%). Despite the fact that many of these products track futures-based indexes, they do not generate a K-1.
CURRENCY FUNDS

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

Currency Open-End Funds

WisdomTree is currently the only issuer to offer currency ETPs structured as open-end funds. Some of its funds include the WisdomTree Dreyfus Chinese Yuan Fund (CYB), WisdomTree Dreyfus Emerging Currency Fund (CEW) and WisdomTree Dreyfus Brazilian Real Fund (BZF).

WisdomTree’s currency funds do not hold currency notes or futures contracts. Instead, most of their funds 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 swaps.

Note, however, that the WisdomTree Dreyfus Euro Fund (EU) and WisdomTree Dreyfus Japanese Yen Fund (JYF) hold short-term money-market debt instruments denominated in local currencies. That said, according to a supplement to their prospectuses, on September 30, 2011, EU and the WisdomTree Dreyfus New Zealand Dollar Fund (BNZ) will soon be renamed and changed to debt funds holding longer-duration debt securities.

Tax implications for these funds are similar to equity funds. According to WisdomTree’s prospectuses, gains are taxed as long-term capital gains (15%) if held for more than one year; if held for one year or less, gains are taxed as ordinary income (maximum 35%).

Currency Grantor Trusts

Rydex’s 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), Swiss Franc Trust (FXF) and Australian Dollar Trust (FXA).

The taxation of CurrencyShares products is straightforward. All gains from the sale of shares are taxed as ordinary income (maximum 35%), regardless of how long they are 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 (EUS) and ProShares UltraShort Yen Fund (YCS).

The tax implications for currency limited partnership ETPs are the same as commodity limited partnership ETPs—gains are subject to the same 60%/40% 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 35%), regardless of how long the shares are held by the investor.

<table>
<thead>
<tr>
<th>STRUCTURE</th>
<th>MAXIMUM TAX RATE</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>LONG-TERM</td>
</tr>
<tr>
<td>Open End (40 Act)</td>
<td>15%</td>
</tr>
<tr>
<td>UIT (40 Act)</td>
<td>N/A</td>
</tr>
<tr>
<td>Grantor Trust (33 Act)</td>
<td>35%</td>
</tr>
<tr>
<td>*Limited Partnership (33 Act)</td>
<td>**23%</td>
</tr>
<tr>
<td>ETN (33 Act)</td>
<td>35%</td>
</tr>
</tbody>
</table>

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

Also, even though currency ETNs don’t pay out any distributions to its shareholders, if a note generates any income throughout the year, investors can be subject to pay taxes on this “phantom income” at year-end.

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

**ALTERNATIVE FUNDS**

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

The tax implications of alternative funds fall in line with the tax implications for equities and commodities with their respective structures. For example, alternative funds structured as open-end funds such as the WisdomTree Managed Futures Strategy Fund (WDTI) and PowerShares S&P 500 BuyWrite Fund (PBP) are taxed like equity funds. Long-term gains are taxed at 15% and short-term gains are taxed as ordinary income (maximum 35%).

Alternative funds that hold futures contracts like some volatility, commodity and currency funds are structured as LPs. Some examples include the PowerShares DB G10 Currency Harvest Fund (DBV), iShares Diversified Alternatives Trust (ALT) and ProShares VIX Short-Term Futures Fund (VIXY). All gains are taxed at the blended 60%/40% rate, regardless of holding period, creating a maximum blended tax rate of 23%.

Alternative funds structured as ETNs currently have the same tax implications as equity ETNs, with the exception of the iPath Optimized Currency Carry ETN (ICI). ICI is considered a currency ETN for tax purposes, with gains 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 ETPs, investors are also subject to 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.

Dividend payments from ETFs are usually paid out monthly, quarterly, semiannually or annually. 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.
Since 2003, qualified dividends get a tax advantage in that they are taxed at a maximum rate of 15%, 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.

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.

Similarly, interest-yielding currency funds such as the CurrencyShares Australian Dollar Trust (FXA) are also taxed as ordinary income. Some currency funds, such as WisdomTree’s funds, can pay out distributions as income from its Treasury holdings, and short-term and long-term gains from its holdings in forward currency contracts.

Funds can also pay out distributions in excess of the fund’s earnings and profits, called return of capital (ROC). ROC is generally nontaxable and reduces the investor’s cost basis by the amount of the distribution. While any fund can potentially pay out ROC distributions, it’s more prevalent in REIT and master limited partnership funds, such as the Alerian Master Limited Partnership Fund (AMLP).

Fortunately for investors, all of this is generally 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 15% tax rate are further separated under the “Qualified Dividends” heading.

Any long-term capital gains that qualify for the 15% 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.

CHOOSING THE RIGHT FUND FOR YOU

There are many reasons besides tax implications for choosing between funds. This paper does not try to address those issues. But knowing the tax implications of different choices can certainly help investors make a decision, especially with commodity and currency funds. We call out a few examples below.

**Commodity Funds**

From a tax perspective, the time period that you expect to own that asset can make a difference. For short-term holders in high tax brackets, for example, LPs offer a strong tax benefit, since 60% of any gains are taxed at the low 15% tax rate, regardless of holding period. In other structures, short-term gains are taxed as ordinary income, with rates up to 35%.

On the flip side, long-term investors might gain an advantage with ETNs because they are subject to 15% long-term gains, compared with the 60/40 blend of partnerships, which comes out to a blended maximum of 23%. The Catch-22 is that ETNs come with credit risk.

Then there are tax reporting differences. The tax structure associated with LPs can be challenging for investors who are accustomed to 1099s when they receive K-1s in the mail. For investors looking to simplify their taxes without K-1s, grantor trusts and ETNs might look more appealing.

**Currency Funds**

While CurrencyShares offers the “purest” way to gain exposure to a currency through an exchange-traded product, any distributed income or gains from selling shares are taxed as ordinary income, so investors don’t get any long-term capital gains tax advantages.
WisdomTree’s open-end funds might have a tax advantage for long-term investors, but, for better or worse, funds using forward contracts don’t always perfectly follow spot exchange rates of the underlying currency.

Similar to commodities, currency limited partnership ETFs can be beneficial for short-term traders because of the blended maximum 23% rate even if shares are held for less than one year. But investors need to deal with K-1 forms, and shares are marked-to-market if they’re held over into a new calendar year.

As always, the choice comes down to the individual. Nonetheless, it pays to have a full understanding of the potential tax treatments so you can make an informed decision.

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.
### Maximum LT/ST Capital Gains Rates (%)

<table>
<thead>
<tr>
<th>FUND STRUCTURE</th>
<th>EQUITY &amp; FIXED INCOME</th>
<th>COMMODITY</th>
<th>CURRENCY</th>
<th>ALTERNATIVE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Open End (40 Act)</td>
<td>15/35</td>
<td>N/A</td>
<td>15/35</td>
<td>15/35</td>
</tr>
<tr>
<td>UIT (40 Act)</td>
<td>15/35</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>Grantor Trust (33 Act)</td>
<td>15/35</td>
<td>28/35</td>
<td>35/35</td>
<td>N/A</td>
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<tr>
<td>*Limited Partnership (33 Act)</td>
<td>N/A</td>
<td>**23/23</td>
<td>**23/23</td>
<td>**23/23</td>
</tr>
<tr>
<td>ETN (33 Act)</td>
<td>15/35</td>
<td>15/35</td>
<td>35/35</td>
<td>15/35</td>
</tr>
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</table>

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

### Commodity Fund Structures and Tax Implications (Detailed)

<table>
<thead>
<tr>
<th>ISSUER</th>
<th>STATE STREET GLOBAL ADVISORS</th>
<th>ETF SECURITIES</th>
<th>BLACKROCK</th>
<th>BLACKROCK</th>
<th>INVESCO POWERSHARES</th>
<th>US COMMODITY FUNDS</th>
<th>UBS</th>
<th>BARCLAYS CAPITAL</th>
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<tr>
<td>Product Line</td>
<td>SPDR</td>
<td>ETFS</td>
<td>iShares</td>
<td>iShares S&amp;P GSCI</td>
<td>PowerShares DB</td>
<td>US Commodity Funds</td>
<td>E-TRACS</td>
<td>iPath Dow Jones-UBS, iPath S&amp;P GSCI</td>
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<td>GLD</td>
<td>SGOL, SIVR</td>
<td>SLV, IAU</td>
<td>GSG</td>
<td>DBC, DBA, DBO</td>
<td>USO, UNG</td>
<td>DJIC, UCI, UAG</td>
<td>DJP, JIA, OIL</td>
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<tr>
<td>Holdings</td>
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<td>Physically Held</td>
<td>Physically Held</td>
<td>Futures Contracts</td>
<td>Futures Contracts</td>
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<td>Structure</td>
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<td>Grantor Trust</td>
<td>Grantor Trust</td>
<td>Limited Partnership</td>
<td>Limited Partnership</td>
<td>Limited Partnership</td>
<td>*ETN</td>
<td>*ETN</td>
</tr>
<tr>
<td>Max LT/ST Rate (%)</td>
<td>28/35</td>
<td>28/35</td>
<td>28/35</td>
<td>**23/23</td>
<td>**23/23</td>
<td>**23/23</td>
<td>15/35</td>
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<td>K-1</td>
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</tbody>
</table>

*The issuer listed in the table may not be the issuing bank of the actual note. Investors should refer to the prospectus for details regarding issuer risk.  **60% of gains taxed as LT gains/40% taxed as ST gains - 23% is the max blended rate.

### Currency Fund Structures and Tax Implications (Detailed)

<table>
<thead>
<tr>
<th>ISSUER</th>
<th>RYDEX</th>
<th>WISDOMTREE</th>
<th>PROSHARES</th>
<th>INVESCO POWERSHARES</th>
<th>INVESCO POWERSHARES</th>
<th>VAN ECK</th>
<th>BARCLAYS CAPITAL</th>
<th>BARCLAYS CAPITAL</th>
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<tr>
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<td>WisdomTree Dreyfus</td>
<td>ProShares</td>
<td>PowerShares DB</td>
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<td>Market Vectors</td>
<td>GEMS</td>
<td>iPath</td>
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<td>CYB, CEW, BZF</td>
<td>EUQ, YCS, ULE</td>
<td>UDN, UUP, DBV</td>
<td>UUPT, UDNT</td>
<td>CNY, INR</td>
<td>AYT, JEM</td>
<td>ERO, JYN, GBB</td>
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<td>Currency</td>
<td>Forward Contracts, Swaps, Repos, Money Markets, Treasuries</td>
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<td>Futures, Options, Swaps, Forward Contracts</td>
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<td>*ETN</td>
<td>*ETN</td>
<td>*ETN</td>
<td>*ETN</td>
</tr>
<tr>
<td>Max LT/ST Rate (%)</td>
<td>35/35</td>
<td>15/35</td>
<td>**23/23</td>
<td>**23/23</td>
<td>35/35</td>
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*IndexUniverse LLC