



**FINANCIAL SERVICES
FOR THE GREATER GOOD®**

Consolidating Your Mutual Funds: Yes or No?

Does it make sense to consolidate any of your mutual fund assets for better recordkeeping and overall organization? The answer depends on whether you can offset or eliminate enough taxes to make it worthwhile.

A mutual fund is a pool of securities, such as stocks and bonds, managed by an investment company adviser. You and other investors purchase shares of a mutual fund. When you decide to sell or redeem some or all of the shares, you may have to pay federal income taxes (and possibly state and local income taxes).

If you're like many people, you have a money market mutual fund for a cash emergency or other short-term financial goal. Contributing to, and withdrawing from, a money market fund on a regular basis isn't much of a tax issue. There generally aren't price gains to tax, since the investment company tries to maintain a \$1 *net asset value*¹ on contributions, and yearly taxes on any dividends are generally easy to keep track of.

Investing in bond and stock mutual funds is different, however. Unlike money market funds, bond and stock mutual funds' share prices fluctuate. As a result, any redemption of shares may create a gain or loss when there's a share price change. Of course, if there's a gain, it will create a taxable event. Similarly, if you transfer stock or bond fund money from one fund to another (even if within the same mutual fund company), taxes may be due, depending on the original and ultimate share price after the transfer.

Throughout your life, you may have invested in bond or stock mutual funds at different companies. You may, for example, have similar growth stock mutual funds at two separate companies. If so, consider if it's sensible to consolidate these assets into one fund—it could make the recordkeeping easier and less expensive by eliminating one fund.

But first do a thorough comparison to make sure you won't be incurring higher costs, back-end charges, or a new sales charge period when you transfer to the new fund. (If you will, be certain it makes sense to absorb these higher costs in the hope of the anticipated higher returns and better recordkeeping.) Also consider if such a transfer/consolidation creates higher taxes for you.

¹Net asset value is usually calculated daily and refers to the fund's total portfolio value, less liabilities.

Here are some basics to discuss with your accountant or advisor before you decide to move any of your money.

Match Gains and Losses

In some cases, if you can match the gains and losses you receive from your mutual funds, you can save on taxes. Specifically, if you offset the gains from selling one mutual fund with the losses from the sale of another fund, you may end up paying no taxes on the gains. And, if your losses exceed your gains, you can deduct up to \$3,000 of these losses against your ordinary income. If these losses exceed \$3,000 in a given tax year, you can carry the losses forward to offset any gains in future years.

Don't forget that you can incur a taxable gain, or a loss, when you sell shares in a "tax-exempt" bond fund, even if the interest you receive is exempt from federal income tax and possibly from state and local taxes. Also be aware that if the portfolio manager of a "tax-exempt" fund sells tax-exempt bonds during the year, you may receive a taxable gain or incur a loss, even if you didn't sell any of your own shares.

Know Your Holding Periods

You may have different purchase dates for your mutual funds, especially if you automatically reinvest your distributions to buy new shares. This may require you to treat any sale as two transactions — one long term and one short term.

For example, say you invest \$10,000 in a mutual fund, acquiring 1,000 shares at \$10 per share in the transaction. Also, assume you participate in the fund's dividend reinvestment program and you elect to reinvest all the dividends. At the end of the year, the fund pays income and capital gain dividends of \$1,000, when the shares' net asset value is \$20 per share.

In this hypothetical scenario, you'll have to pay taxes on the dividends, even though you reinvested them. But as a result of the reinvestment, you now own two share lots, each with its own purchase date and cost basis:

- Lot 1 represents your original purchase of 1,000 shares, acquired at \$10 per share and worth \$10,000
- Lot 2 represents your 50 shares, acquired at \$20 per share and worth \$1,000

If you sell any of these shares, you'll need to identify the lot and the correct cost basis to determine the gain or loss on the transaction.² Selling various blocks of shares

²If you sell a portion of your shares at a loss and buy additional shares from the same fund during the 30-day period before or after the sale, the IRS will consider this a "wash sale," and will disallow all or a portion of the loss.

that have a higher- or lower-than-average tax basis may transform a potentially large taxable gain into a smaller taxable gain, or even into a loss for tax purposes. (The original tax basis for your shares is their cost, unless you acquired the shares by gift or inheritance.)

Tax law requires that you use either a *cost-basis method* or an *average-basis method* for determining your gain or loss in these circumstances. There are two types of cost-basis methods [*Specific Identification* and *First-In First-Out (FIFO)*] and two types of average-basis methods (*Single-Category Method* and *Double-Category Method*). As you can tell, this is fairly technical information you should discuss with your tax advisor. You can also call us at **800 223-1200** to learn more.

Track It All

When you sell TIAA-CREF mutual fund shares, in February of the following year, we'll send you a statement showing shares' average-basis price under the *Single-Category Method*. To use the other average-basis method, or one of the two cost-basis methods, you must track your shares' purchase dates, quantities and prices, and whether they were purchased outright or acquired through dividend or capital gain reinvestment.

TIAA-CREF mutual funds report the "amount realized," that is, the amount you received from the sale, redemption or exchange of a mutual fund, on IRS Form 1099-B as gross proceeds. This is because TIAA-CREF mutual funds do not charge commissions on sales, redemptions or exchanges of shares.

There's no denying that mutual fund recordkeeping and basis calculations can be time consuming. But if you do it correctly, you'll be better able to decide whether consolidation makes sense, and, if it does, to maximize your after-tax income.

Estate Planning Issues

Before you consolidate your mutual funds, carefully consider if you want to pass on one or more mutual funds to a beneficiary. If you do, consolidating your mutual funds may not make sense because of the "stepped-up basis" rule. This rule states that if you die while owning a mutual fund that's appreciated in value, the appreciation (unrealized capital gain) is not subject to ordinary income tax. As a result, your beneficiary starts off with a clean slate, paying income taxes only on the additional accumulation from the time he or she inherits the fund.

However, don't confuse income taxes with estate taxes. Your beneficiary's inherited mutual fund may be subject to estate taxes, regardless of the "stepped-up basis" rule. To learn more, contact us at **800 223-1200**.

To learn more about retirement planning and other TIAA-CREF financial services, visit us at www.tiaa-cref.org, [schedule an appointment online](#), or call a consultant at **800 842-2776**.

This article covers a complex topic. Before making any change to your mutual fund account(s), consult your accountant and/or attorney for advice that's specific to your goals and circumstances. The article uses "you" only in a general sense.

The tax information provided here is not intended to be used, and cannot be used by any taxpayer, for the purpose of avoiding tax penalties that may be imposed on the taxpayer. It was written to support the promotion of the products and services mentioned here. Taxpayers should seek advice based on their own particular circumstances from an independent tax advisor. Neither TIAA-CREF nor its affiliates offer tax advice.

TIAA-CREF Individual & Institutional Services, LLC, and Teachers Personal Investors Services, Inc., members FINRA, distribute securities products. ***You should consider the investment objectives, risks, charges and expenses carefully before investing. Please call 877 518-9161 or log on to www.tiaa-cref.org for a prospectus that contains this and other information. Please read the prospectus carefully before investing.***

© 2008 Teachers Insurance and Annuity Association-College Retirement Equities Fund (TIAA-CREF), New York, N.Y. 10017

C40461