FACT SHEET ON H.R.
LEGISLATION TO PROVIDE A PARTIAL EXCLUSION FOR MUTUAL FUND CAPITAL GAINS DISTRIBUTIONS

Under current law, capital gains are generally subject to tax when realized by taxpayers. However, mutual fund shareholders are one exception to this generalization. Because mutual funds distribute capital gains they annually realize to mutual fund shareholders, these shareholders pay taxes on capital gains they have not themselves realized, even though they may have sold no shares of their mutual funds.

This tax policy discriminates against mutual fund owners, undermines incentives for saving and investment by lowering the preliquidation rates of return, and creates a potential for additional multiple taxation.

H.R. addresses this situation by providing income exclusions amounting to $5,000/$10,000 (single/married couple) on income received in the form of reinvested mutual fund capital gains distributions. This exclusion would effectively defer the taxation of some capital gains distributed to mutual fund shareholders until they sell their shares.

The bill would increase the rate of return to saving and investment, and thus tend to encourage thrift, financial responsibility and independence.

Under current law, there is the potential for many investors to double pay their capital gains tax, once when distributed, and again when they sell shares and forget to add the reinvested distributions to their basis. This potential for double taxation would be reduced for most middle class shareholders.

Under the current law, shareholders in funds whose share values have remained flat or even fallen are liable for capital gains realized by the mutual fund. In other words, the value of their investments may have fallen, yet they must pay tax on capital gains they have not realized.

This year, mutual fund shareholders may find themselves in this tax situation. It is possible that millions of shareholders will find themselves with large tax bills even as the value of their mutual fund investment has declined. Mutual funds and policymakers may find the current tax law difficult to explain to frustrated investors.

A change in policy is needed to prevent this kind of situation developing now and in the future.