LEARN | Tax Treatment of Different Investment Vehicles

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Mutual funds, exchange-traded funds (ETFs) and separately managed accounts (SMAs) each have a place in your client's portfolio, but there are different considerations to keep in mind when it comes to taxation and asset location.

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Key Takeaway

By understanding how each investment vehicle is taxed, you'll be better positioned to guide clients in making tax-smart asset allocation and asset location choices.

Comparison of Mutual Funds, ETFs and SMAs

Although mutual funds, ETFs and SMAs share many of the same characteristics, there are several distinguishing features to consider.

	Mutual Funds	ETFs	SMAs
Customization	No	No	Yes, allows for the exclusion of individual holdings based on investor preferences.
Funding	Cash	Cash	Cash or in kind
Tax Treatment	**Tax Inefficient** Trading activity from rebalancing and redemption can cause capital gain allocations to investors.	**Tax Efficient** Fund structure enables the mitigation of capital gain realization caused by rebalancing and redemptions.	**Tax Managed** Holding individual securities allows an investor to elect for loss harvesting* and enables better control of gain realization.
Locations to Consider	Tax deferred and tax exempt accounts	Either tax deferred, tax exempt or taxable accounts	Taxable accounts

Next Steps

Review your client's portfolios.
Identify possible opportunities for improved asset location.
Meet with clients to discuss.

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The Importance of Asset Location

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There is no assurance that investment objectives will be achieved.

Investment strategies that seek to enhance after-tax performance may be unable to fully realize strategic gains or harvest losses due to various factors. Market conditions may limit the ability to generate tax losses. Tax-loss harvesting involves the risks that the new investment could perform worse than the original investment and that transaction costs could offset the tax benefit. Also, a tax-managed strategy may cause a client portfolio to hold a security in order to achieve more favorable tax treatment or to sell a security in order to create tax losses. Prospective investors should consult with a tax or legal advisor before making any investment decision.

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Eaton Vance

HEADQUARTERS
One Post Office Square
Boston, MA 02110

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