

A TALE OF TWO INVESTORS:

A REVIEW OF THEIR 1099 TAX FORMS

Taking a closer look at your Form 1099-DIV can be eye-opening. Your financial professional or CPA can help you connect the dots between your December 31 investment statement and your April 15 tax bill. Form 1099-DIV is one of many IRS tax forms and is used to record investment-related income. This simple guide walks you through what to look for along with insights, implications, and actions you may want to take to improve the tax efficiency of your investments.

How much might the IRS take from Joe & Joan Traditional Taxpayer?

Their year-end investment statement stood at **\$1,000,000**, BUT after paying taxes to the IRS, it went down to **\$984,813**.

Taxes reduced their investment return by **1.5%** and this assumes no active trading during the year.

Take a closer look at their 1099-DIV to see how this can happen.



Joe & Joan Traditional Taxpayer

Household Taxable Income: \$400,000

Marginal Tax Rate on Unearned Income: 35.8% (32% + 3.8% NIIT*)

Long-Term Capital Gain/Qualified Dividend Tax Rate: 18.8% (15% + 3.8% NIIT*)

Filing Status: Married filing jointly

Investments:

- **Equity Mutual Fund**
\$500,000 Balance
1.3% Yield / 12% Capital gain†
distribution (average % for U.S. equity in 2021)
- **Taxable Bond Mutual Fund**
\$500,000 Balance
1.5% Yield

CORRECTED (if checked)		OMB No. 1545-0110	
PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.		1a Total ordinary dividends	Form 1099-DIV (Rev. January 2022)
Mutual Fund Company		\$ 14,000	For calendar year 20
		1b Qualified dividends	
PAYER'S TIN		\$ 6,500	
RECIPIENT'S TIN		2a Total capital gain distr.	2b Unrecap. Sec. 1250 gain
Joe & Joan Traditional Taxpayer		\$ 60,000	
		2c Section 1202 gain	2d Collectibles (28%) gain
RECIPIENT'S name		\$	
Street address (including apt. no.)		2e Section 897 ordinary dividends	2f Section 897 capital gain
City or town, state or province, country, and ZIP or foreign postal code		\$	
Account number (see instructions)		3 Nondividend distributions	4 Federal income tax withheld
11 FATCA filing requirement		\$	
		5 Section 199A dividends	6 Investment expenses
		\$	
		7 Foreign tax paid	8 Foreign country or U.S. possession
		\$	
		9 Cash liquidation distributions	10 Noncash liquidation distributions
		\$	
		12 Exempt-interest dividends	13 Specified private activity bond interest dividends
		\$	
		14 State	15 State identification no.
		16 State tax withheld	
		\$	

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Box 1a: Total Ordinary Dividends:
Dividend from mutual fund: **\$6,500**
Interest income from mutual fund: **\$7,500**
Total Ordinary Dividends: **\$14,000**

Box 1b: Qualified Dividends
 $\$6,500 \times 18.8\% = \mathbf{\$1,222}$ in federal taxes (A)

Box 1a - Box 1b = Non-Qualified Dividends**
 $\$14,000 - \$6,500 = \$7,500$
 $\$7,500 \times 35.8\% = \mathbf{\$2,685}$ in federal taxes (B)

Box 2a: Total Capital Gain Distribution
 $\$60,000 \times 18.8\% = \mathbf{\$11,280}$ in federal taxes (C)

Box 12: Exempt-Interest Dividends
Interest income from municipal bond funds. Generally, tax-free at the federal level. Joe & Joan had \$0 in municipal bonds.

Four boxes to review

Box 1a: Total Ordinary Dividends

- Includes qualified dividends
- Includes non-qualified dividends
- Includes net short-term capital gain distributions from mutual funds and/or real estate investment trusts (REITs)
- Includes taxable interest income from mutual funds (not just dividends)

Box 1b: Qualified Dividends

- Dividends paid by a U.S. company or qualifying foreign company

- Not all foreign dividends are qualified
- Generally, lower tax rate for qualified dividends

Box 1a - Box 1b = Non-Qualified Dividends

- Includes interest income
- Includes dividends from REITs
- Taxed as ordinary income and often a higher corresponding tax rate

Box 2a: Total Capital Gain Distributions

- Net long-term capital gain distributions from mutual funds or REITs

Summary of taxes

- (A) Tax on dividends: **\$1,222**
- (B) Tax on interest income: **\$2,685**
- (C) Tax on capital gains: **\$11,280**

Total Federal Tax Due: \$15,187
Percent lost to taxes: -1.52%

A hypothetical illustration.

*Net Investment Income Tax of 3.8%.

**Any non-qualified dividends are taxed as ordinary income at 35.8%.

† Using 2021 average capital gain distribution % of Morningstar broad category 'US Equity' which includes mutual funds and ETFs.

How about a tax-managed investor such as Uncle Sam & Aunt Betsy?

Contrasting with Joe & Joan on the prior page, let's look at tax-aware investors in two distinct mutual funds; their \$500,000 U.S. large cap fund has a full-year focus on tax-management and their \$500,000 in fixed income is invested in a municipal bond fund. So, while Joe & Joan received the average taxable distribution from their investments, Uncle Sam & Aunt Betsy took advantage of an investment approach with a full-year focus on tax-management and their results were quite different:

Their year-end investment statement stood at **\$1,000,000** and after paying taxes to the IRS, it's only down to **\$999,859**.

They lost just **0.1%** of their investment return to the payment of taxes.

Take a closer look at their 1099-DIV to see how this can happen.

PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.		1a Total ordinary dividends		OMB No. 1545-0110	
Mutual Fund Company		\$ 750		Form 1099-DIV (Rev. January 2022) For calendar year 2022	
		1b Qualified dividends			
PAYER'S TIN		\$ 750		2b Unrecap. Sec. 1250 gain	
		2a Total capital gain distr.			
RECIPIENT'S TIN		\$ 0		2c Section 1202 gain	
		2e Section 897 ordinary dividends			
RECIPIENT'S name Uncle Sam & Aunt Betsy		\$		2d Collectibles (28%) gain	
		3 Nondividend distributions		2f Section 897 capital gain	
Street address (including apt. no.)		\$		4 Federal income tax withheld	
		5 Section 199A dividends		6 Investment expenses	
City or town, state or province, country, and ZIP or foreign postal code		\$		7 Foreign tax paid	
		9 Cash liquidation distributions		8 Foreign country or U.S. possession	
Account number (see instructions)		\$		10 Noncash liquidation distributions	
		11 FATCA filing requirement		13 Specified private activity bond interest dividends	
12 Exempt-interest dividends		\$ 4,500		16 State tax withheld	
14 State		15 State identification no.		16 State tax withheld	
		\$		\$	

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Uncle Sam & Aunt Betsy Tax-Aware Taxpayer

Household Taxable Income: \$400,000
Marginal Tax Rate on Unearned Income: 35.8% (32% + 3.8% NIIT*)

Long-Term Capital Gain/Qualified Dividend Tax Rate: 18.8% (15% + 3.8% NIIT*)
Filing Status: Married filing jointly

Investments:

- **Tax-Managed Equity Mutual Fund**
\$500,000 Balance
0.15% Yield / No capital gain distribution
- **Municipal Bond Mutual Fund**
\$500,000 Balance
0.9% Yield (generally tax free at federal level)

Box 1a: Total Ordinary Dividends:
Dividend from mutual fund: \$750
Taxable int. income from mutual fund: \$0
Total Ordinary Dividends: \$750

Box 1b: Qualified Dividends
\$750 X 18.8% = \$141 in federal taxes (A)

Box 1a - Box 1b = Non-Qualified Dividends**
\$750 - \$750 = \$0
\$0 X 35.8% = \$0 in federal taxes (B)

Box 2a: Total Capital Gain Distribution
\$0 X 18.8% = \$0 in federal taxes (C)

Box 12: Exempt-Interest Dividends
Interest income from municipal bond funds
Generally, tax-free at the federal level.
\$4,500 X 0% = \$0 in federal taxes

A hypothetical illustration. *Net Investment Income Tax of 3.8%. **Any non-qualified dividends are taxed as ordinary income at 35.8%.

Summary of taxes

(A) Tax on dividends:	\$141
(B) Tax on interest income:	\$0
(C) Tax on capital gains:	\$0
Total Federal Tax Due:	\$141
Percent lost to taxes:	-0.01%

How low can you go?

A quick comparison of two hypothetical cases:

As you see here, two taxpayers with the same portfolio value can potentially end up with very different outcomes on an after-tax basis.

Note that these two couples had same investment amount and materially different federal tax bills. Details matter as no one wants to pay more than they have to the IRS.

Remember, you DON'T need to be in the top tax bracket to feel the pinch from taxes.

	Joe & Joan Traditional Taxpayer	Uncle Sam & Aunt Betsy Tax-Aware Taxpayer
Year-end investment statement showed:	\$1,000,000	\$1,000,000
Federal tax due from:		
Dividends	\$1,222	\$141
Interest Income	\$2,685	\$0
Capital Gains	\$11,280	\$0
Total Federal Tax	\$15,187	\$141
After-tax value:	\$984,813	\$999,859
Percent of investments lost to taxes:	-1.52%	-0.01%

Between a Rock and Hard Place?

Here are some ideas on changes to consider:

CAPITAL GAIN DISTRIBUTIONS (BOX 2A)

Q: Are these distributions high for your investment amount? Are the capital gains being reinvested?

A: If these distributions are being reinvested, look into turning off that reinvestment, and migrate that cash into a tax-managed approach that may work to minimize capital gains.

DIVIDENDS (BOX 1A/1B)

Q: Is there a need for the dividend income? Are the dividends being reinvested?

A: If these dividends are being reinvested, look into turning off that reinvestment, and migrate that cash into a tax-managed approach that may work to balance dividends with capital appreciation.

INTEREST INCOME (BOX 1A)

Q: Is there a need for this current income? Is interest income being reinvested?

A: Consider municipal bonds for tax free income or a lower tax bill.

TRANSITION PLAN

Q: Do you have a similarly frustrating tax bill year after year after year? When was the last time you rebalanced your portfolio? Are you letting the potential tax bill influence your decision-making?

A: It may make sense to transition all (or part) of the portfolio to a more tax-managed approach. Understand the tax impact of a transition, if any, and what the payback period might be. Russell Investments can work with your financial advisor to help analyze potential taxes and the payback period for portfolio transitions.

REALLOCATIONS, TACTICAL TRADING AND FUND REPLACEMENTS

Q: Does the portfolio trade frequently due to reallocations, tactical adjustments or fund replacements?

A: Frequent trading within a taxable portfolio can result in unnecessary taxes when positions with unrealized gains are constantly and/or systematically sold. When making changes to a taxable portfolio always be sure to consider the tax consequences. Smaller and less frequent allocation changes may be better for tax-sensitive investors so that benefits from portfolio improvements are not outweighed by tax costs.

**“WHEN YOU FIND
YOURSELF IN A HOLE,
THE FIRST THING TO
DO IS STOP DIGGING.”**

—WILL ROGERS

2022 Federal Income Tax Brackets (Short-term capital gains are taxed as ordinary income.)

Tax Rate	Married Filing Jointly	Single	Married Filing Separately	Head of Household
10%	\$0 - \$20,550	\$0 - \$10,275	\$0 - \$10,275	\$0 - \$14,650
12%	\$20,551 - \$83,550	\$10,276 - \$41,775	\$10,276 - \$41,775	\$14,651 - 55,900
22%	\$83,551 - \$178,150	\$41,776 - \$89,075	\$41,776 - \$89,075	\$55,901 - \$89,050
24%	\$178,151 - \$340,100	\$89,076 - \$170,050	\$89,076 - \$170,050	\$89,051 - \$170,050
32%	\$340,101 - \$431,900	\$170,051 - \$215,950	\$170,051 - \$215,950	\$170,051 - \$215,950
35%	\$431,901 - \$647,850	\$215,951 - \$539,900	\$215,951 - \$323,925	\$215,951 - \$539,900
37%	Over \$647,850	Over \$539,900	Over \$323,925	Over \$539,900

2022 Long-Term Capital Gains/Qualified Dividend Tax Rates

Tax Rate	Married Filing Jointly	Single	Married Filing Separately	Head of Household
0%	\$0 - \$83,350	\$0 - \$41,675	\$0 - \$41,675	\$0 - \$55,800
15%	\$83,351 - \$517,200	\$41,676 - \$459,750	\$41,676 - \$258,600	\$55,801 - \$488,500
20%	Over \$517,200	Over \$459,750	Over \$258,600	Over \$488,500

2022 Standard Deduction¹, NIIT² Threshold, Capital Loss Limit³

	Married Filing Jointly	Single	Married Filing Separately	Head of Household
Standard Deduction	\$25,900	\$12,950	\$12,950	\$19,400
3.8% NIIT Thresholds⁴	\$250,000	\$200,000	\$125,000	\$200,000
Capital Loss Limit	\$3,000	\$3,000	\$1,500	\$3,000

Source: Internal Revenue Service

¹ Blind, or age 65 or older: +\$1,400 (Married); +\$1,750 (Single or Head of Household).

² Net investment income tax.

³ If your capital loss exceeds your capital gains.

⁴ Modified adjusted gross income (MAGI).

Talk to your financial professional and/or tax accountant to see what steps can be taken to potentially minimize your tax burden.

Or visit russellinvestments.com to discover the benefits of tax-managed investing.

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