Bridgeway Capital Management, Inc.

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Upcoming Tax Code Changes Could Cost You

Ways to Protect Your Capital from an IRS Bite

We don't know your individual tax situation and can't offer tax advice. But we do encourage you to look at tax strategies and consult your tax adviser well before the end of 2012, as some tax laws have already changed and others could change significantly at year's end.

What's Changing

Taxes. A high level of stress accompanies this not-so-popular topic for most people at tax filing time. Consequently, most people put off their tax planning until the last minute. However, for 2012, this could be a costly mistake. In fact, now may be the time to be thinking about the impact your investment decisions could have on your taxes for 2012. There are several reasons 2012 is crucial. First, the Bush tax cuts of 2001 and 2003, which were extended for two years in December 2010, are set to expire at the end of 2012. Should this happen, tax rates on capital gains, dividends, and income would increase for most Americans. Second, our national debt is at record levels, and the government will necessarily be looking for ways to reduce this burden. Third, the IRS implemented new tax lot laws on mutual funds purchased after January 1 of 2012. This means that you may need to make a decision about the cost basis method you will use for your mutual fund purchases and redemptions. If you invest significantly in a taxable account, your cost basis method is worth paying attention to. Bridgeway prepared a document about cost basis reporting that may be helpful when making your decision.

Potential Strategies to Avoid Taxes

So what should you do? Time to get that paperwork together! First, you should understand your cost basis and tax liabilities in each of your investments so you know where your liabilities may be. Second, you should consider this information throughout the year and be intentional about your tax management based on any rule changes. Don't wait until next April when it could be too late.

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Finally, going forward, here are some general ideas on methods for reducing taxes and increasing your net returns (of course, you should consult your tax adviser):

1. **Minimize your turnover (that is, be a long-term investor).** Historically, long-term gains (longer than one year of holding) have been taxed at a lower rate than short-term gains. By being a long-term investor, you not only have the possible benefit of lower taxes, but you will also be less likely to try to "time" the market with your investments — an investment strategy that research shows on average to be overwhelmingly destructive.

2. **Look to invest in tax-efficient mutual funds.** You can use Morningstar or look in the prospectus to gauge which managers are best at tax management. This is something we take seriously at Bridgeway.

3. **Donate your appreciated mutual fund shares.** Yes, you can do this. It grieves us when we hear of investors selling their appreciated shares in a taxable account to make a donation to charity. Give the shares and avoid paying taxes on any appreciated investment. It means more money for your charity and possibly more impact for your cause.

This Thought Capsule has been adapted from a portion of the market review that originally appeared in the Bridgeway March 2012 Quarterly Report.