

Mutual Fund Tax Equalization

Diamond Hill Funds use tax equalization to help reduce year-end capital gain distributions to shareholders.

All mutual funds must distribute to shareholders any net realized gains from the sale of individual securities in their portfolio, and those distributions are subject to income tax unless held in a tax-free or tax-deferred retirement account.

“Equalization” is a practice used to reduce capital gain distributions to fund shareholders. With each shareholder redemption throughout the year, a portion of the fund’s realized gains are deemed to have already been distributed as part of that redemption and are excluded from our year-end capital gain distribution amounts for remaining shareholders. Redeeming shareholders are unaffected by equalization, while the remaining shareholders benefit from the practice.

The benefits of tax equalization for fund shareholders can vary greatly from year to year and from fund to fund. Generally, the larger the gross redemptions for a fund, the larger the equalization credits. On average, the use of tax equalization has reduced Diamond Hill Funds’ capital gain distributions by approximately 10-15%. Equalization effectively serves as a tax deferral strategy by allowing shareholders to retain more of their own personal unrealized gains, rather than receiving those as taxable capital gain distributions. This practice does not increase the administration costs of our funds.

Diamond Hill is committed to doing what is in the best interest of our clients. To determine if a fund uses tax equalization, you can review the distribution sections of the footnotes in the fund’s audited financial statements to see if they disclose something similar to the following: “Certain funds may utilize earnings and profits distributed to shareholders on redemption of shares as part of the dividends paid deduction for income tax purposes.”

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HYPOTHETICAL EXAMPLE

\$20 Net Asset Value (NAV)

\$1 Undistributed Realized Gains
\$2 Unrealized Gains
\$17 Cost



Shareholder redeems one share at \$20 NAV per share



\$1 of realized gains deemed to be distributed through the redemption, reducing the remaining capital gain distribution for remaining shareholders*

* The actual equalization credit that is used to reduce the year-end capital gain distributions is the actual number of shares redeemed divided by the total outstanding shares multiplied by the total undistributed realized gains in the fund as of the date of the redemption.

The shareholder has a taxable transaction on their redemption, but their specific realized gain/loss is solely based on their individual cost basis in the shares of the fund and not based on the realized gains deemed to have been distributed to them by the fund. Thus, if the shareholder’s cost basis was \$15 per share and they redeemed at \$20 per share, the shareholder would have realized gains of \$5 per share regardless of whether or not the fund used tax equalization.

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