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## The Hidden Cost of Taxes

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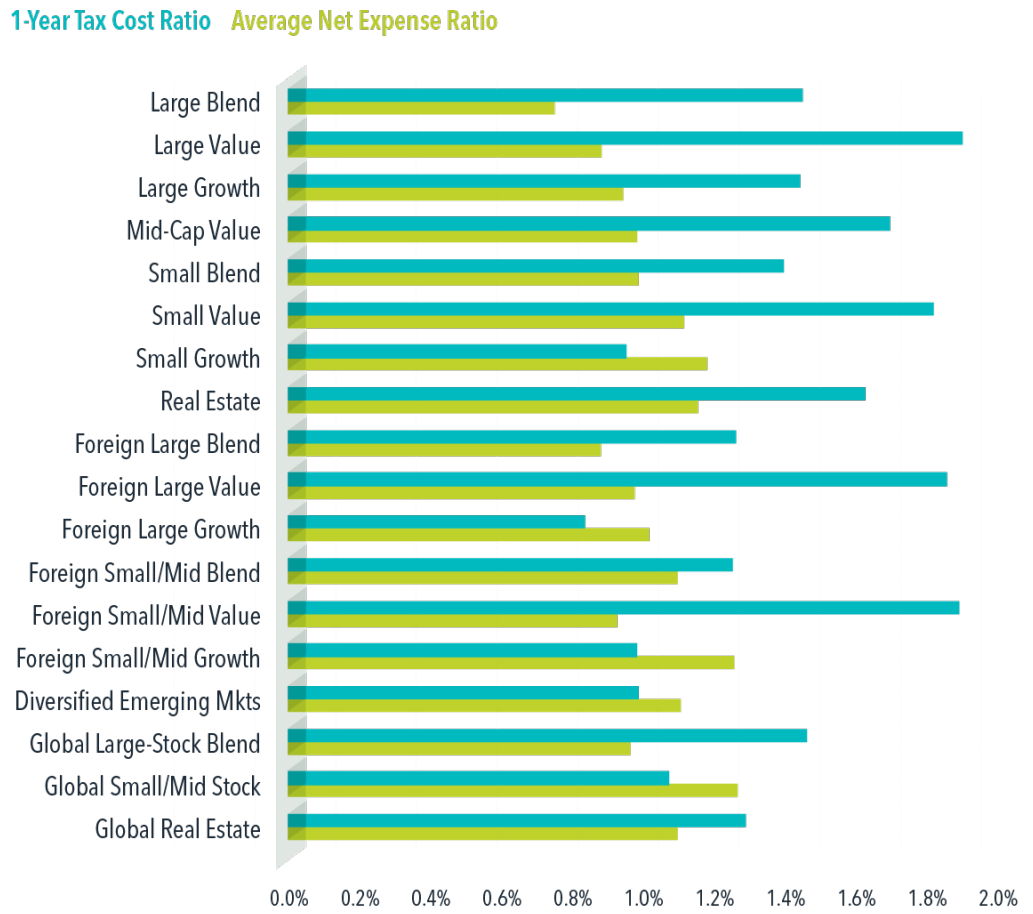
Like the tip of an iceberg, expense ratios reveal only the easily visible costs of investing in a mutual fund or ETF. Beneath the surface are hidden costs that can potentially play an even larger role in eroding returns. For taxable investors, one of the most significant is tax cost—the difference between what a fund earns before taxes and what investors keep after taxes.

One way to gauge this impact across different funds is by looking at their tax cost ratios, which measure how much a fund's annualized return is reduced by the taxes paid on its capital gains and income distributions. The tax cost ratio reflects the impact on tax efficiency of a manager's activity inside the portfolio. For example, tax costs can be influenced by the amount of trading in the fund, how many short- and long-term capital gains are realized, and what percentage of income is [qualified versus nonqualified](#).<sup>1</sup>

With strong market performance over the past year, tax cost ratios across Morningstar categories were higher than average expense ratios as of one year ending September 30, 2025. For taxable investors, this is a reminder that what's visible on the surface—expense ratios—may only be part of the story. Hidden costs, such as taxes, can have a big impact on the returns that investors ultimately earn from their mutual fund or ETF investment.

### Exhibit 1

Morningstar Category  
Tax Cost Ratio vs. Net  
Expense Ratio as of  
September 30, 2025



*Data sourced from Morningstar. Tax cost ratio represents how much a fund's annualized return is reduced by the taxes investors pay on distributions. Tax cost ratio is calculated using the highest individual federal income tax rate in effect and does not reflect state and local taxes. After-tax returns depend on an investor's particular tax situation and may differ from those shown here. The net expense ratio reflects fees after taking into account any such fee waiver and/or expense assumption arrangements.*