THE FACTS ABOUT RETURN OF CAPITAL & INVESTING

Disspelling the myths on Return of Capital

WHAT IS RETURN OF CAPITAL?

Return of Capital or (ROC) is commonly referenced in distributions paid by some investments. A distribution from the investment can be made up of several characteristics. In its simplest form, a distribution is the dividend paid from your investment based on earnings which is taxable. ROC on the other hand, is a distribution is from non-earnings related items that is paid to the investor from their original capital. ROC is not immediately taxed when received.

WHY IS A RETURN OF CAPITAL ISSUED?

ROC is usually issued by managers to investors seeking a higher level of consistent income than they can receive from just a simple dividend. In cases like this, there would be a return of your original capital to meet the distribution, which will reduce the price or net asset value (NAV) of your investment by the ROC. This is in turn creates a deferred capital gain until selling the investment.

IS RETURN OF CAPITAL GOOD OR BAD?

ROC can take good and bad forms. The bad form of ROC is when the income from the portfolio does not cover the target distribution. This is where your invested capital is literally returned to you and is usually called a “grind on NAV” (price). Although tax efficient, the investment really isn’t growing over all.

Good ROC is usually harvested from an options strategy overlay of the investments held. In this case, money is received from writing options and any losses from options, offset any capital gains triggered in the portfolio.

Note: if you are using borrowed funds to invest and you receive ROC, if the ROC is not invested in another income generating investment, the ROC advantage will be lost and it will be taxed as income.

WANT TO LEARN MORE ABOUT ROC? CONTACT US.

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