

ABOVE THE FRAY

The Hidden Cost of Taxes

Karen Umland, CFA
Senior Investment Director and Vice President

Nov 18, 2025

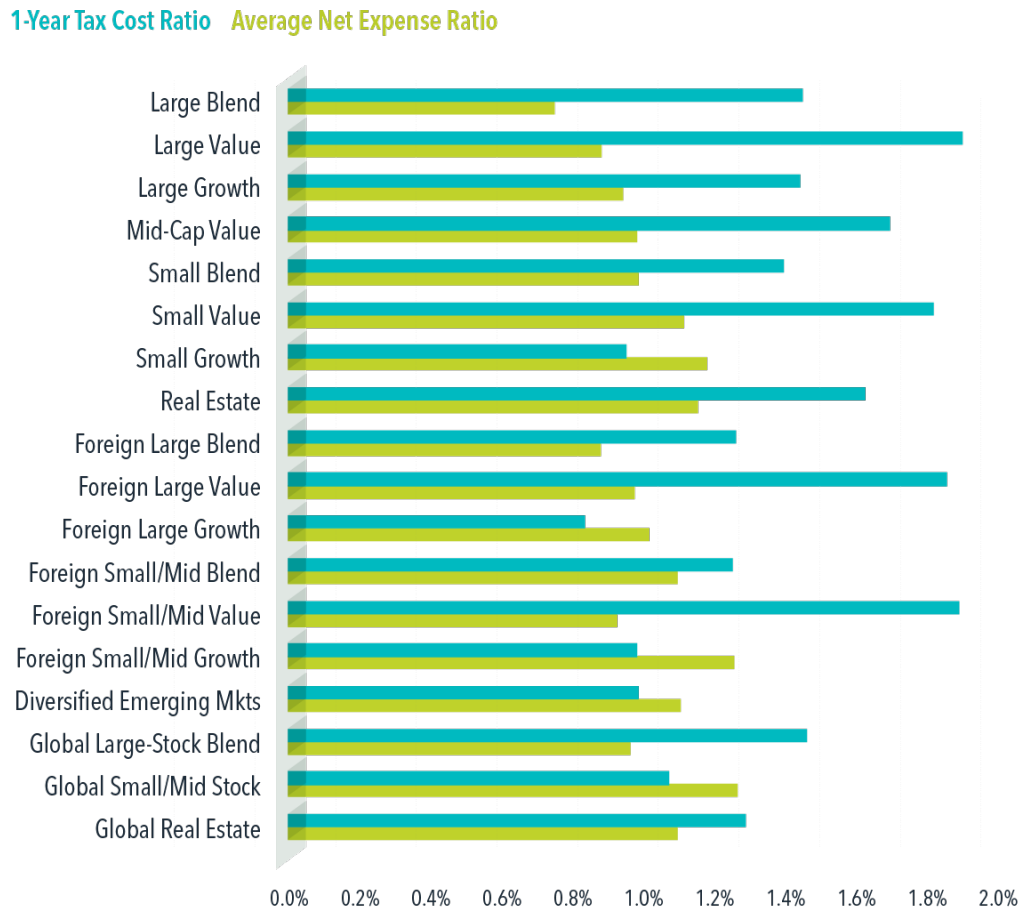
Like the tip of an iceberg, expense ratios reveal only the easily visible costs of investing in a mutual fund or ETF. Beneath the surface are hidden costs that can potentially play an even larger role in eroding returns. For taxable investors, one of the most significant is tax cost—the difference between 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](#).¹

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.

LEARN MORE

[Does Gold Hedge Economic Downturns?](#)

[Managing Dividend Income to Improve Your Tax Health](#)

[Sometimes It Helps to Pay Less Attention](#)

1. Qualified dividend income is taxed at lower capital gains tax rates, while nonqualified income is taxed at higher ordinary income rates.

The information in this material is intended for the recipient's background information and use only. It is provided in good faith and without any warranty or representation as to accuracy or completeness. Information and opinions presented in this material have been obtained or derived from sources believed by Dimensional to be reliable, and Dimensional has reasonable grounds to believe that all factual information herein is true as at the date of this material. It does not constitute investment advice, a recommendation, or an offer of any services or products for sale and is not intended to provide a sufficient basis on which to make an investment decision. Before acting on any information in this document, you should consider whether it is appropriate for your particular circumstances and, if appropriate, seek professional advice. It is the responsibility of any persons wishing to make a purchase to inform themselves of and observe all applicable laws and regulations. Unauthorized reproduction or transmission of this material is strictly prohibited. Dimensional accepts no responsibility for loss arising from the use of the information contained herein.

This material is not directed at any person in any jurisdiction where the availability of this material is prohibited or would subject Dimensional or its products or services to any registration, licensing, or other such legal requirements within the jurisdiction.

"Dimensional" refers to the Dimensional separate but affiliated entities generally, rather than to one particular entity. These entities are Dimensional Fund Advisors LP, Dimensional Fund Advisors Ltd., Dimensional Ireland Limited, DFA Australia Limited, Dimensional Fund Advisors Canada ULC, Dimensional Fund Advisors Pte. Ltd., Dimensional Japan Ltd., and Dimensional Hong Kong Limited. Dimensional Hong Kong Limited is licensed by the Securities and Futures Commission to conduct Type 1 (dealing in securities) regulated activities only and does not provide asset management services.

RISKS

Investments involve risks. The investment return and principal value of an investment may fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original value. Past performance is not a guarantee of future results. There is no guarantee strategies will be successful.

UNITED STATES

Dimensional Fund Advisors LP is an investment advisor registered with the Securities and Exchange Commission.

Investment products: • Not FDIC Insured • Not Bank Guaranteed • May Lose Value

Dimensional Fund Advisors does not have any bank affiliates.

This information is intended expressly for discussion purposes only and should not be misconstrued or otherwise interpreted as legal or tax advice. Please consult with qualified legal or tax professionals regarding your individual circumstances.

dimensional.com



12/11/2025

<https://my.dimensional.com/the-hidden-cost-of-taxes>