

# MANAGING FUNDS FOR AFTER TAX RETURNS: UNRESOLVED ISSUES ABOUT UNREALISED GAINS

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# AGENDA

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MANAGING FOR AFTER TAX RETURNS: DIFFICULTIES & ADVANTAGES

ACTUAL PRACTICE (UNDER AUSTRALIAN TAX)

REPORTING AFTER TAX RETURNS: FIVE METHODS

AMBIGUOUS VALUE OF UNREALSIED GAINS?

# MANAGING FOR AFTER TAX RETURNS

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## DIFFICULTIES:

DIFFICULT

COMPLEX

ADDITIONAL TO FIN ACCT.

# MANAGING FOR AFTER TAX RETURNS

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## DIFFICULTIES (CNT):

MANAGE CGT RULES

INVESTOR'S TAX STATUS ?

POST-TAX BENCHMARKS?

MARKET DISRUPTION

COMPLIANCE COSTS

# MANAGING FOR AFTER TAX RETURNS

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**BENEFITS:**

**PRE-TAX BEATS AFTER TAX RETURN**

**BUT**

**CONVERT PRE-TAX TO POST TAX**

**POST-TAX MANAGING WINS**

(IS YOUR ALPHA BIG ENOUGHT TO PAY TAXES?  $\Delta$  250 bps)

# MANAGING FOR AFTER TAX RETURNS

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**BENEFITS (cont):**

**IMPORTANT TO INVESTOR DECIDING**

**BETTER INFORMED DECISIONS**

**COMPETE ON OTHER VARIABLES**

(US Sec research when making after tax reporting compulsory)

# MANAGING FOR AFTER TAX RETURNS

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BENEFITS (cont):

TAX BIGGEST EXPENSE

GROWING INVESTOR DEMAND

# AFTER TAX RETURN MANAGEMENT PRACTICES

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## AUSTRALIAN TAX CONDITIONS:

CGT REALISATION

DEFERRED TAX = INTEREST FREE GOVT. LOAN

12 MONTH=50%/33% DISCOUNT ON TAX

TURNOVER REDUCES DEFERRAL

'CHOLESTEROL' TURNOVER: LOSS HARVESTING +VE

IMPUTATION CREDIT (investor gets credit for corp. taxes)  
EFFICIENCIES

# REPORTING AFTER TAX RETURNS

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## FIVE METHODS:

US SEC

IFSA

TAX COST RATIO (MORNINGSTAR)

ACCRUAL EQUIVALENT

TAX ADJUSTED, RISK ADJUSTED DISCOUNT RATE

# REPORTING AFTER TAX RETURNS

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US SEC

AVERAGE ANNUAL TOTAL RETURN

AVERAGE ANNUAL TOTAL RETURN (AFTER TAXES ON DISTRIBUTIONS)

AVERAGE ANNUAL TOTAL RETURN (AFTER TAXES ON DISTRIBUTIONS AND REDEMPTIONS)

1, 5 AND 10 YEAR CALCS

HYPOTHEICAL \$1000 INVESTMENT

# REPORTING AFTER TAX RETURNS

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IFSA

AFTER TAX RETURN EXPRESSED AS PERCENTAGE  
CHANGE IN INVESTMENT VALUE

PRE-LIQUIDATION: DISTRIBUTIONS REINVESTED AFTER  
TAX

POST-LIQUIDATION: AFTER TAX VALUE OF  
REDEEMED INVESTMENT

HIGHEST MTR AND 15% REQUIRED, OTHER RATES  
OPTIONAL

# REPORTING AFTER TAX RETURNS

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TAX COST RATIO (MORNINGSTAR)

RATIO OF AFTER TAX TO BEFORE TAX RETURNS

TAX EFFICIENCY MEASURE

ISOLATES TAX EFFECT

GOOD COMPARATOR

# REPORTING AFTER TAX RETURNS

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ACCRUAL EQUIVALENT:

CGT BURDEN = ACCRUAL EQUIVALENT CGT RATE

ACCRUAL EQUIVALENT CGT RATE IS WHAT  
MANAGER WOULD HAVE HAD TO HAVE EARNED  
ASSUMING ALL DISPOSALS AT END OF PERIOD

# REPORTING AFTER TAX RETURNS

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TAX ADJUSTED RISK ADJUSTED DISCOUNT RATE

RECOGNISES DEFERRED TAX LIABILITIES FROM  
UNREALISED GAINS

ESTIMATE OF AFTER TAX FUTURE CASH FLOWS AND  
VALUE

APPLY A TAX ADJUSTED RISK ADJUSTED DISCOUNT  
RATE

# UNREALSIED GAINS

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BERGSTRESSER/POTERBA MUTUAL FUND INFLOW  
STUDY:

EFFECT OF TAX BURDEN ON FUND INFLOWS

AFTER TAX RETURN NEGATIVE TO FUND IN-FLOWS

AFTER TAX RETURNS BETTER AT EXPLAINING FUND  
INFLOWS THAN PRE TAX

LARGE UNREALISED GAINS > SMALLER INFLOWS

# UNREALSIED GAINS

BERGSTRESSER POTERBA MUTUAL FUND INFLOW  
STUDY:

UNREALISED GAINS +VE FOR AFTER TAX RETURNS  
BUT -VE TO INFLOWS

UNRESOLVED ISSUES:

?INVESTOR'S DO NOT WANT EXITING INVESTOR'S  
LIABILITY?

?SHOULD FUNDS DISCLOSE UNREALISED GAINS?

?IF SO, WHAT METHOD?

CLOSE

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-VE TO FUND INFLOWS BUT +VE TO AFTER TAX RETURNS

? MORE WORK?