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ICI Stresses Importance of Investor Awareness of Tax Impact, October 1999

ICI Stresses Importance of Investor Awareness of Tax Impact on Mutual Fund Returns

Washington, DC, October 29, 1999 - In testimony today before a House subcommittee, the Investment Company Institute said it is important that mutual fund investors understand the impact that taxes can have on returns generated in their taxable or "non-retirement" accounts.

"Mutual fund shareholders who have taxable accounts need to understand the impact that taxes can have on the returns generated by their investments," said ICI President Matthew P. Fink. "Ensuring a strong understanding of the tax consequences of fund investing is entirely consistent with the Institute's long-standing support for initiatives to improve disclosure to investors."

Fink's remarks came in testimony before the House Subcommittee on Finance and Hazardous Materials, during a hearing on H.R. 1089, the "Mutual Fund Tax Awareness Act of 1999," which would direct the Securities and Exchange Commission (SEC) to develop a rule to require mutual funds to disclose the effects of taxes on returns to fund investors. Fink said the Institute supports the bill's objectives to improve the disclosure to investors of the effects of taxes on a mutual fund's performance.

"A threshold matter that the SEC will have to resolve is whether it would be best to expand upon the existing required tax-related disclosures in prospectuses and shareholder reports, or to require funds to calculate one or more after-tax return numbers," Fink said.

Fink explained that if an after-tax return number is used, one of the most significant computation issues would be whether the return should be computed on a pre-liquidation basis, which assumes that the investor continues to hold all shares at the end of the measurement period; or on a post-liquidation basis, which assumes the investor redeems all shares at the end of the measurement period; or whether both figures should be prepared.

Other significant issues to be resolved involve the applicable federal and/or state income tax rates to be used in calculating after-tax returns.

Fink stressed that it is "extremely important" that any after-tax numbers be accompanied by disclosure that informs investors of their appropriate use and inherent limitations. "Otherwise, investors could misunderstand them, and even be misled," he cautioned.

Fink said investors will need to know that actual after-tax returns will vary from investor to investor, depending on each investor's federal and state tax rates and their own individual circumstances. "Of course, for investors who hold fund shares in IRAs, 401(k) plans, or other non-taxable accounts, after-tax returns will have no relevance," Fink said.

Perhaps most significantly, Fink said, investors must understand that after-tax return numbers are not "predictive." Fink explained that a fund that has been highly tax efficient in the past could easily have significant taxable distributions in the future, and that the size, scale, and timing of these distributions are sometimes beyond the control of the fund's manager.

Fink pledged that the Institute would continue to work with Congress and the SEC to achieve a result that will be most useful for the nation's 83 million shareholders.

The Investment Company Institute is the national association of the investment company industry. Its members include mutual funds, closed-end funds, and unit investment trusts.