

IFSA Guidance Note No. 25.00



Product Performance - Calculation of After-tax Returns

June 2008

Main features of this Guidance Note are:

- **to specify the principles to be adopted when calculating After-tax Returns [for reporting before-tax product performance, Members should apply IFSA Standard No. 6 - Product Performance: Calculations of Returns. For reporting fund manager composite performance, Members should apply IFSA Guidance Note No. 1.00: Global Investment Performance Standards (GIPS)];**
- **to facilitate accurate comparisons amongst Products;**
- **to provide guidance in the interpretation and application of those principles; and**
- **to standardise the practices, procedures and terminology relating to the calculation of After-tax Returns.**

IFSA Guidance Note No. 25.00

Table of Contents

	<u>Paragraph</u> :	<u>Page</u>
Title.....	1	3
Guidance Note and Commentary.....	2	3
Date of Issue.....	3	3
Effective Date.....	4	3
Application.....	5	3
Statement of Purpose.....	6	3
Definitions.....	7	5
Assumptions in the calculation of After-tax Returns.....	8	6
Application of After-tax Returns	9	7
Presentation of After-tax Returns	10	9
Schedule 1 Personal Marginal Tax Rates		
Schedule 2 Sample Disclosure of Returns		

IFSA Guidance Note No. 25.00

1 Title

- 1.1 **This Guidance Note may be cited as IFSA Guidance Note No. 25.00 “Product Performance - Calculation of After-tax Returns”.**

2 Guidance Note and Commentary

- 2.1 **The guidelines set out in this Guidance Note are shown in bold print; commentary is shown in normal print immediately after a guideline, as an interpretation aid to the guideline.**

3 Date of Issue

- 3.1 **25 June 2008.**

4 Effective Date

- 4.1 **This Guidance Note should be applied in relation to the calculation of After-tax Returns for Products on or after 1 July 2008.**

5 Application

- 5.1 **This Guidance Note should be applied by Scheme Operators (whether offered for public subscription or otherwise) when calculating and presenting After-tax Returns for unlisted Schemes where Scheme Holder benefits are market linked. Note that this Guidance Note applies to “Product”, not “fund manager”, performance.**

6 Statement of Purpose

- 6.1 **The purpose of this Guidance Note is:**

- **to specify the principles to be adopted when calculating After-tax Returns [for reporting before-tax product performance, Members should apply IFSA Standard No. 6 - Product Performance: Calculations of Returns. For reporting fund manager composite performance, Members should apply IFSA Guidance Note No. 1.00: Global Investment Performance Standards (GIPS)];**
- **to facilitate accurate comparisons amongst Products;**
- **to provide guidance in the interpretation and application of those principles; and**
- **to standardise the practices, procedures and terminology relating to the calculation of After-tax Returns.**

6.1.1 A Scheme Holder that wishes to compare the After-tax Returns of a Product will require the Scheme Operator to produce returns that are calculated on a comparable basis. If

IFSA Guidance Note No. 25.00

all Scheme Operators calculate their returns on a comparable basis it will be possible to compare returns between Products (i.e. conduct peer to peer comparisons). Comparisons between before-tax market indices and after-tax returns for a product may not be meaningful due to the impact of tax.

6.1.2 Scheme Operators providing After-tax Returns should provide a total after-tax return. This will allow comparison of Products after-tax returns at a total level. Whilst the IFSA Standard No. 6 Product Performance – Calculation of Returns allows for the provision of a distribution return and a growth return, this granularity is not necessary when calculating After-Tax Returns for a Product.

6.1.3 After-tax Returns should be calculated at a Product level. A Product is a Scheme or a sub-set of a Scheme. For example, a class of units within a managed investment scheme, or a nil entry fee option, are all separate Products for the purposes of this Guidance Note. Return calculations should take into account any fees or costs incurred by a Scheme Holder when investing in the Scheme generally (and not just by reference to only those fees or costs incurred when investing in the Product). Fees should be reflected in a manner consistent with IFSA Standard No 6:00 “Product Performance – Calculation of Returns”.

6.1.4 The valuation of Product assets and Product pricing are key elements in the determination of After-tax Return calculations. The principles and procedures to be adopted by Scheme Operators to ascertain the value of Product assets and to price those assets are described in IFSA Standard No. 9.00 “Valuation of Scheme Assets and Liabilities” and IFSA Standard No. 8.00 “Scheme Pricing”.

6.1.5 It is desirable that there should be an industry guideline for calculating After-tax Returns that is, as much as practically possible, consistent with the measurement of Product Performance (as per IFSA Standard No. 6 Product Performance – Calculation of Returns).

6.1.6 Proper disclosure of the methodology used to calculate After-tax Returns is appropriate to avoid inadvertently misleading Scheme Holders and other users of these returns.

6.1.7 This Guidance Note may not cover every situation faced by Members when calculating a Product’s After-tax Returns. Where a situation is not covered, a Member should have regard to the intent of this Guidance Note as described in the Statement of Purpose.

6.2 The principles to be adopted in the calculation of After-tax Returns in relation to a Product are:

- **comparability;**
- **use of standard industry terminology;**
- **consistency; and**
- **use of a transparent methodology.**

IFSA Guidance Note No. 25.00

6.2.1 If After-tax Returns are to be used to compare the investment performance of Products, then all returns should be calculated on a comparable basis.

6.2.2 Consistency should be sought with regard to After-tax Return calculations. If the Guidance Note is to be consistent with generally accepted practices, then returns for periods less than 1 year must not be annualised (refer to IFSA Standard 6.00). Given the complexities with reporting After-tax Returns, returns for periods less than one year are not recommended.

6.2.3 Transparency of calculation is required so that researchers, Scheme Holders and financial planners can reproduce the returns published by Scheme Operators. This makes it easier for interested parties to verify published returns and help foster a perception of integrity within the industry.

7 Definitions

7.1 In this Guidance Note:

- **‘After-tax Return’ means the percentage change in a continuing Scheme Holder’s interest in a Product assuming the reinvestment of all Distributions net of the tax effects applicable to that distribution, (if applicable) broken into both Pre-liquidation (ignores tax on unrealised gains/losses) and Post-liquidation (incorporates tax on unrealised gains/losses) After-tax Returns.**
- **‘Cum-Distribution’ means that the distribution is included in the unit price.**
- **‘Distribution’ means the cash amount (in cents per unit) that is paid to continuing Scheme Holders after the end of a Distribution Period. This amount excludes any Franking Credits and Foreign Tax Credits associated with the Distribution.**
- **Grossed-up Total Return means the percentage change in a continuing Scheme Holder’s interest in a Product assuming the reinvestment of all Distributions grossed-up for any Franking Credits (if applicable) back into the Product (and no other acquisition or disposal/withdrawal) and adjusting for any capital reorganisation (if applicable). All Franking Credits should be assumed to be reinvested at the end of the tax year.**
- **‘Pre-liquidation After-tax Return’ means the percentage change in a continuing Scheme Holder’s interest in a Product assuming the reinvestment of all Distributions net of the tax effects applicable to that Distribution (if applicable). This measure has no provision for tax on unrealised gains/losses at the reporting date.**
- **‘Post-liquidation After-tax Return’ means the percentage change in a continuing Scheme Holder’s interest in a Product assuming the reinvestment of all Distributions net of the tax effects applicable to that Distribution (if applicable), assuming that the Scheme Holder’s investment in the Product is redeemed at the effective date of the return calculation.**

IFSA Guidance Note No. 25.00

- ‘Product’ is a Scheme or a part of a Scheme (where different characteristics apply to distinct groups of Scheme Holders). *Each product is a unique offering comprising a pool of assets, from a number of Scheme Holders, which are invested with a common investment mandate, and share a common set of fees and conditions. Therefore each product will have its own unique performance. For example, Nil Entry and Entry Fees options will comprise separate Products. Individual investment options available within a Scheme will comprise separate Products and different classes within a Scheme will comprise separate Products.*
- ‘Reinvestment Price’ means the unit price at which Scheme Holders, that elected to automatically reinvest their Distributions, purchased additional units in the Product.
- ‘Scheme’, for the purposes of this Guidance Note, means a managed investment scheme within the meaning of the *Corporations Act 2001*, or financial product (with an investment component) issued by a company regulated under the *Life Insurance Act 1995*.
- ‘Scheme Holder’ means those persons, whether they are natural persons or not, in whose name an interest in a Scheme may be registered from time to time.
- ‘Scheme Operator’ means the trustee, operator, issuer, responsible entity, trustee of a registerable superannuation entity, or life insurer (as the case may be) for the Scheme.

7.2 The use of industry terms should conform with the definitions of terms as set out in IFSA Guidance Note No. 5.00 “Industry Terms and Definitions”, and avoid the use of ambiguous terminology.

8 Assumptions in the calculation of After-tax Returns

8.1 Scheme Holder’s are Australian resident taxpayers for income tax purposes in line with the *Income Tax Assessment Act 1936* as amended.

8.2 Scheme Holder’s hold units on capital account.

8.3 The discount capital gains method (subsection 115-25(1) *Income tax Assessment Act 1997*) is assumed to be applied within the Scheme for all assets when estimating the tax on unrealised gains and losses.

8.4 All tax credits distributed by the Scheme can be fully utilised by Scheme Holders.

8.5 Buy/sell spread ignored on initial purchase of units and on full redemption of units. Returns are calculated on a redemption to redemption unit price basis.

8.6 Capital gains concessions are always available to Scheme Holders.

IFSA Guidance Note No. 25.00

8.7 Scheme Holders will be able to immediately offset any capital loss made on their units against long term capital gains from other sources.

9 Application of After-tax Returns

9.1 Scheme Operators will apply the following tax rates that apply at the time of the distribution:

- actual highest personal marginal income tax rate (as defined in row E in Schedule 1) plus medicare levy, and
- the superannuation tax rate of 15%.

9.1.1 Scheme Operators may elect to use the following rates of tax in the calculation of the After-tax Returns in addition to the actual highest personal marginal tax rate

Type	Tax rate
Tax exempt	0.00%
Low tax bracket	as defined in row B in Schedule 1
Mid tax bracket	as defined in row C in Schedule 1

(please note that these rates should be increased by the Medicare levy where appropriate).

9.2 The calculation of After-tax Returns is to occur at the end of the financial year once the final distribution has been determined.

9.3 From the Effective Date, the calculation of After-tax Returns is to cover a period of 5 years where data is available.

9.3.1 Scheme Operators may elect to calculate After-tax Returns for periods of more or less than 5 years where data is available.

9.4 Distributions are assumed to be reinvested after-tax back into the Product at the actual Reinvestment Price paid by Scheme Operators that elected to automatically reinvest their Distributions, with effect on the last day of the Distribution period.

9.4.1 The after-tax distribution amount is derived as follows:

$$\text{After-tax Distribution Amount} = \{ \sum (\text{TC}) * (1-\text{TR}) \} + \text{TF} + \text{TD}$$

IFSA Guidance Note No. 25.00

Where:

TC	=	Taxable components including but not limited to: Total franked dividends plus associated Franking Credits Unfranked dividends Taxable component of realised capital gains Interest income Other Australian income Foreign sourced income plus associated Foreign Tax Credits Passive foreign income
TR	=	Tax rate at the time of distribution
TF	=	Tax-free components including but not limited to: Building depreciation allowance Realised Capital gains that are non-assessable Other non-assessable income
TD	=	Tax-deferred components Depreciation Other tax deferred
TCR	=	Tax credits Franking credits Foreign tax credits

(please note that the components/elements listed above are cited as examples only and are subject to change).

9.5 The calculation of After-tax Returns is to be completed on a Pre-liquidation and Post-liquidation basis.

9.5.1 The Pre-liquidation After-tax Return should be calculated by constructing a Pre-liquidation After-tax Total Value Index series or equivalent data. The Index reflects the cumulative value of a continuing Scheme Holders' investments assuming the reinvestment of all After-tax Distributions (also allowing for any capital reorganisation). For example, the annualised After-tax Return for “#” years is as follows:

$$After - tax - Return_{@ EndOfPeriod} = \left[\left(\frac{After - tax - Total - Value - Series_{@ EndOfPeriod}}{After - tax - Total - Value - Series_{@ StartOfPeriod}} \right)^{(1/\# yrs)} - 1 \right] * 100$$

9.5.2 The Post-liquidation After-tax Return should be calculated by constructing a Post-liquidation After-tax Value Index series or equivalent data. The Index reflects the

IFSA Guidance Note No. 25.00

cumulative value of a continuing Scheme Holders' investments assuming the reinvestment of all After-tax Distributions (also allowing for any capital reorganisation) and for the tax payable on the redemption of units in the Product as at the reporting date. For example, the annualised Post Liquidation After-tax Return for “#” years is as follows:

$$PL_After-tax_Return_{@EndOfPeriod} = \left[\left(\frac{PL_After-tax_Total_Value_Series_{@EndOfPeriod}}{After-tax_Total_Value_Series_{@StartOfPeriod}} \right)^{(1/\#yrs)} - 1 \right] * 100$$

Where:

$$PL_After-tax_Value_Series_{@EndOfPeriod} =$$
$$After-tax_Value_Series_{@EndOfPeriod} - Tax$$

Where:

Tax = the tax payable on redemption of units in the Product as at the reporting date

The calculation of Tax in the formula above is based on the cumulative growth component of total returns for the reporting period assuming reinvestment of after-tax distributions. The calculation assumes the tax rate applicable to long-term capital gains taxes, except where units have been acquired in the twelve months immediately preceding the reporting date. The calculation of tax should also take into account the carried forward tax free and tax deferred components of the income of the Scheme.

10 Presentation of After-tax Returns

Scheme Operators should report the Grossed-up Total Return, the After-tax Returns (both Pre Liquidation and Post Liquidation) and any corresponding Total, Growth and Distribution Return or reference where to get information on the After-tax Returns if applicable. Scheme Operators should also report the percentage of the Distribution represented by Taxable Components (TC in 9.4) for both individual unit holders and superannuation fund unit holders. Also, the percentage of the Distribution represented by Tax Credits (TCR in 9.4) should be reported.

10.1 The Distribution, the percentage represented by Taxable Components and the percentage represented by Tax Credits allow approximate After-tax Return calculations. The approximation does not distinguish between Tax Free and Tax Deferred components of the distribution.

10.2 Full disclosure of the methodology used to calculate After-tax Returns is required at all times, where this is different to the methodology recommended in the Guidance Note.

10.2.1 Footnoted or endnoted comments are satisfactory for this purpose and should direct investors to the appropriate place to find a full explanation of the methodology of the calculation.

IFSA Guidance Note No. 25.00

10.3 The terminology Pre-liquidation After-tax Returns and Post-liquidation After-tax Returns should be used when presenting after-tax returns.

10.4 The following commentary should be included when presenting Pre-liquidation After-tax Returns and Post-liquidation After-tax Returns.

- After-tax returns should only be viewed as a guide to the After-tax position of an investor in the Product;
- After-tax returns depend on an investor's individual tax situation and may differ from those shown;

IFSA Guidance Note No. 25.00

Schedule 1

Personal Marginal Tax Rates

	YEAR												
	1995/96	1996/97	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08
Rate %													
A	-	-	-	-	-	-	-	-	-	-	-	-	-
B	20	20	20	20	20	17	17	17	17	17	15	15	15
C	34	34	34	34	34	30	30	30	30	30	30	30	30
D	43	43	43	43	43	42	42	42	42	42	42	40	40
E	47	47	47	47	47	47	47	47	47	47	47	45	45
Threshold \$													
A	5,400	5,400	5,400	5,400	5,400	6,000	6,000	6,000	6,000	6,000	6,000	6,000	6,000
B	20,700	20,700	20,700	20,700	20,700	20,000	20,000	20,000	21,600	21,600	21,600	25,000	30,000
C	38,000	38,000	38,000	38,000	38,000	50,000	50,000	50,000	52,000	58,000	63,000	75,000	75,000
D	50,000	50,000	50,000	50,000	50,000	60,000	60,000	60,000	62,500	70,000	95,000	150,000	150,000
E	>50,000	>50,000	>50,000	>50,000	>50,000	>60,000	>60,000	>60,000	>62,500	>70,000	>95,000	>150,000	>150,000

IFSA Guidance Note No. 25.00

Schedule 2

Sample Disclosure of Returns

Returns for the period to 30 June 2007

	1 year % pa	3 years % pa	5 years % pa
<u>Returns (after fees but before tax as per IFSA Standard 6:00)</u>			
Distribution Return	8.0%	7.3%	7.6%
Growth Return	5.0%	3.0%	2.8%
Total Return	13.0%	10.3%	10.4%
<u>Gross-up Total Returns</u>	14.4%	11.6%	11.6%
<u>Superannuation Fund After-tax Returns</u>			
Pre-liquidation	13.5%	10.7%	10.8%
Post-liquidation	13.0%	10.4%	10.5%
<u>Top Marginal Tax Rate Investor After-tax Returns</u>			
Pre-liquidation	11.9%	9.0%	9.0%
Post-liquidation	10.7%	8.3%	8.5%
<u>Other Tax Disclosures</u>			

IFSA Guidance Note No. 25.00

Proportion of Distribution taxable for Superannuation Funds	73%		
Proportion of Distribution taxable for Individual Investors	68%		
Proportion of Distribution represented by Tax Credits	17%		

After-tax returns should only be viewed as a guide to the After-tax position of an investor in the Product;
After-tax returns depend on an investor's individual tax situation and may differ from those shown