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Technology

Easing the Taxing State of Reporting Income

By Tom Steinert-Threlkeld

Little known to even practitioners in the industry—such as mutual fund managers—is that mutual fund companies and exchange-traded fund issuers actually have to pay taxes in each state where they have investors.

The investors pay, on their gains. But so do fund companies, which have to show how they are calculating the returns they have earned on the investments they make and are apportioning them by state, in relation to the portions of the funds held by investors in each state.

Easier said than done. After all, how do you know how much of your fund's capitalization is held by investors in zip code 06880?

You don't.

This bottom line business issue is giving rise to a technical solution that is likely to be launched soon after the turn of the year by the **Access Data** unit of **Broadridge Financial Solutions**.

That's when Access Data, acquired by Broadridge in May 2009, is likely to introduce a **Multi-State Tax Management** module for its **SalesVision** software, aimed at mutual fund and ETF operators.

The online service, which draws on asset positions gathered from financial intermediaries, will figure out share positions of which funds have been held in which zip codes for what durations. The answers get rolled up into amounts that then can get applied against the management fees earned in each fund. Pro rating the earnings against the amounts held (and for how long) in each zip code then can get rolled up into totals for full years for each state.



Which means much more precise calculation of income earned for a given year in a given state, in collector terms.

“Really, what funds need is to determine where shareholder positions are by state, be able to apply the fees earned for each fund, so they can determine income earned in each state and calculate tax obligations based on state rules,” said **Frank Polefrone**, senior vice president at Access Data.

To this point, the approaches to figuring out what income has been achieved in each state is akin to this: determine how many customers you had in each state at the beginning of the year, how many you had at the end, how much was invested in your fund at the beginning of the year, pro rate first against the populations of

each state, then adjust for how your investor base compared to that norm and go.

Calculating income by state as a result has been “basically very difficult to do and almost impossible to do with a great degree of accuracy,” Polefrone said. Why? “Because in this business, so much of the data, the underlying shareholder data, is held away from the transfer agent. It's on either omnibus accounts or other third-party systems where it's very difficult to get these asset positions and be able to break it out.”

In effect, you have aggregate numbers on how much is invested and how many investors you have. But matching them up and coming up with actual amounts invested by party or by state is not easy.

Access Data's state-by-state tax calculating tool attempts to make it easy or easier, by calculating estimated returns and estimated taxes by zip code, and then rolling them up into state results to help produce quarterly tax estimates to meet year-end state tax obligations.

Data from brokers and other sources are rolled up at designated intervals, like each month, to improve accuracy on the estimates how much income has been earned in each state and provide a clearer basis for then calculating the tax owed.

Individual monthly shareholder positions are available to calculate average asset holdings and associate the average positions within each state.

An analytical dashboard that is in development intends to make it easy to review asset positions by state, as well as income and tax obligations at a state level.

Thus, if a fund complex knows how much it's earned on a particular fund, how much of it is held in each state and for what period of time, it can then calculate income by state by fund.

In the Broadridge case, it's not the first time it has tackled this type of question. The engine of the income-by-state calculator is essentially the same as that in the engine that calculates what payments have to be made to distributors by a fund complex.

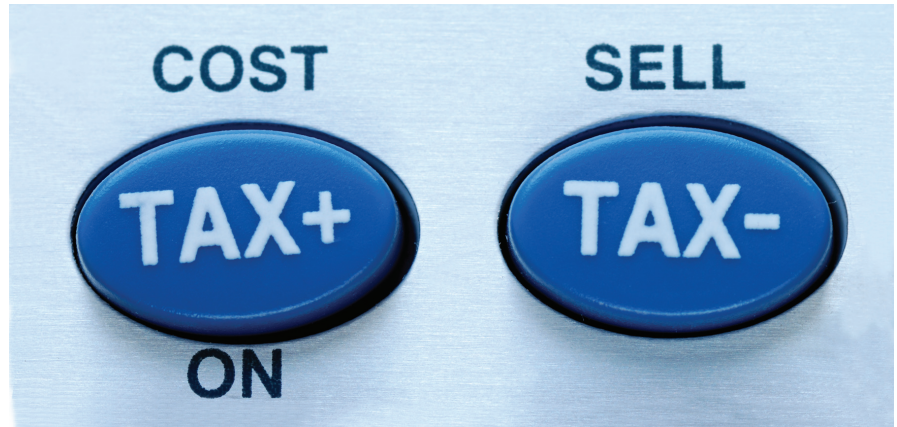
To pay appropriate fees and commissions to distributors, you have to figure out how much of your fund they control, how much is earned and where. And then pay out. Figuring out the income for your fund, by state, almost becomes a by-product.

But it's not an easy task. Your approach still has to withstand scrutiny of any state that wants to audit how you arrive at an income (or tax) calculation.

Which makes what Access Data is about to deliver potentially significant.

"This is the first time anybody has really taken information and applied it against something as difficult as tax reporting," Polefrone said.

The multi-state tax reporting module for Salesvision follows the October introduction of tools that let fund managers zero in on fund performance by region or representative. The Market Intelligence tool allows fund managers to effectively see what share of the market for mutual funds or ETFs a fund manager or distributor has in a given part



of the country, on a monthly basis.

That "intelligence" comes from rolling up reporting on asset positions from the majority of distributors in an industry, combining data available from Broadridge, with technology tools from Access Data.

The result is an ability for top sales, marketing and product managers to see more than just how many shares are moving through a given distribution channel or distributor, but what those distributors positions are.

And how those positions compare to the amount and value of shares held by customers of other firms. **MME**

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