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FUND MANAGERS AND COST-BASE REPORTING

As mutual fund and hedge fund managers are increasingly becoming abreast of new regulation, changing accounting standards mark a top priority for managers who need to keep their investors keenly aware of their tax implications.

Fund investors need to watch out for the 30-day wash sale rule, according to George Michaels, chief executive of G2 Systems.

"The last thing investors want is to have to pay taxes on losses; even if the fund manager lost value," Michaels told Markets Media.

The Internal Revenue Service's (IRS) 30-day wash sale rule prohibits investors from claiming a tax loss on the sale of a security, when the same investment was purchased within 30 days before or after the sale date.

According to Michaels, hedge fund investors are aware of the IRS wash sale rule. "Hedge fund investors are savvy. Many of them are wealthy individuals, and when there's more capital at stake, it becomes more important to understand the implications," he said. "No one likes to pay taxes."

The same may not be true for mutual fund investors, who will be "double unhappy getting hit with a tax bill if they incurred capital losses," said Michaels.

The rule is put in place to prevent investors from participating in predatory tactics of selling stocks, taking a capital loss—and thus, tax deduction—and immediately repurchasing the same stocks to keep value in the portfolio.

The trickiness of taxes can be made easier with G2's cost basis reporting system, known as TaxGopher, according to Michaels. The firm specializes in bringing tax software in-house to funds, which mitigates the need for firms to outsource to an accounting firm.

Traditionally, evaluating accurate capital gains have been done by hand, which is not always efficient and accurate, according to Michaels.

"Frequently, buyside funds will say: 'We hire GlobeOp, CISCO, and Ernst & Young to manage our taxes— we don't worry about it. We just focus on making money," said Michaels.

Such laissez-faire attitude can be costly for firms who outsource, and may subject them to an audit from the IRS regarding possible inaccuracies of reporting capital gains and losses.

"To increase your bullet proof compliance level, it's better to use a standard software package," noted Michaels. "Computers are much better suited to report capital gains accurately to investors—it's all about managing investors' expectations."

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GEORGE MICHAELS, CHIEF EXECUTIVE OF G2 SYSTEMS.