CLARIFYING BOOK VALUE

Who would have thought "book value" was so confusing? Clarifying a common issue on your account statements.

When investors view their account statement, a common misconception is to compare the difference between the "book value" (also known as adjusted cost base, or "ACB") of their portfolio vs. the market value, in order to determine how much money was made or lost in their account over a given period. It sounds pretty straightforward, right? At least that's what Accounting 101 taught us. However, comparing these values usually leads to inaccurate conclusions regarding actual account performance.

The book value includes all your contributions to the fund. However, if you elect to receive the fund distributions in units, your book value is adjusted by the automatic reinvestment of distributions. In simple terms, when a fund pays a distribution you get taxed on it, but when the distribution is in fund units, the book value increases at the same time by the amount of the distribution to avoid double taxation. This information is reported on your T3 slip (Relevé 16 for Quebec residents).

Therefore, your book value could increase even if you don't contribute more money to your portfolio, making it a misleading metric to use to evaluate how your portfolio has done. Book value will also be impacted by your withdrawals.

Why can't we just forget about book value? Book value is actually used for non-registered plans when calculating capital gains and losses for income tax purposes. Any capital gains or losses triggered by a redemption or a switch, are reported on a T5008 tax slip (Relevé 18 for Quebec residents).

How can I tell how much I've made if I can't use book value? You should look for the "amount invested" in your statements and compare it to the "market value" to calculate how much you've made or lost on a given investment. "Amount invested" excludes any reinvested distributions, but will include all your contributions and withdrawals. You can find this information on most dealer account statements.

I can't believe I'm saying this, but show me the math!

Okay! Here's a hypothetical investor. What was the client's return?

- Client invested $40,000 on July 9, 2015
- She received three years of distributions totalling $11,000
- Book value is (40,000 +11,000) = $51,000
- Current market value = $51,880

Old me (wrong calculation)

Return = (Market value - Book value) /Book value
= (51,880 - 51,000) /51,000
= 1.73% cumulative return

New-and-improved me (right calculation)

Return = (Market value - amount invested) /amount invested
= (51,880 - 40,000) /40,000
= 29.7% cumulative return

The mystery of book value, solved!

Book value is not an appropriate representation of the total amount invested. Rather, it's used to calculate capital gains and losses for income tax purposes. To calculate your true performance, use your market value and amount invested from your statement. While this information may not appear on your monthly statements, most dealers put it on their annual statement with the actual return. If you don't have this information, please contact your advisor for assistance.

More about distributions

What is a mutual fund distribution?

It's when the net investment income earned by a mutual fund is passed on to individual investors. The distributions can be paid out in cash or reinvested in additional mutual fund units.

Why am I getting a distribution?

Distributions are allocated to investors according to the number of units they own of the fund on the day prior to the distribution (record date). The length of time an investor owns units of the mutual fund has no bearing on the rate of the distribution payout.

Why is it beneficial for investors to pay the tax instead of the mutual fund?

Mutual funds are taxed at the equivalent of investors' highest marginal tax rate. If the fund doesn't distribute the investment income it will pay tax on the lump sum at the highest rate. By distributing its investment income to investors the income is typically taxed at a much lower rate (or none at all if it's held in a registered account). It's in everyone's best interest to have the mutual fund pay a distribution. Reducing the tax paid by the fund increases the income that can be distributed to investors, which improves the return on their investment.

Why does net asset value (NAV) drop when a distribution is paid?

Distributions reduce the fund's NAV/units per share by the amount of the distribution because after the payout, the fund holds less assets. Said another way, the NAV is the value of the underlying assets so when a mutual fund pays out a distribution, it stands to reason that the NAV would drop by that same amount.

Is the taxman double dipping?

Annually, when you receive your distribution (reported on your T3/Relevé 16) and reinvest it, the amount that you receive gets added to your investment's Adjusted Cost Base (ACB). So when you eventually sell your investment, you have a lower capital gain because the ACB is higher. It's kind of like a prepayment of tax on your eventual capital gain. If you look at your investment's cost base in your account, at the end of the year, you should notice that it's higher than the amount that you originally invested. That increase would be the distribution that you receive and the end of the year which will be reported on your T3 (Relevé 16 for Quebec residents).