

“Tax and Tax Overhang Effects on Funds Flow and Performance of Actively Managed Bond Funds”

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ABSTRACT

This article examines the possible linkage between tax effects (both realized gains/losses and unrealized gains/losses) and flow of funds for actively managed corporate bond funds over the period 1997 to 2006. Using a sample of 741 corporate bond funds that exist at some time during that ten-year period, the findings of this essay indicate that new investors to bond funds are sensitive to unrealized capital gains/losses, however, the flow of funds is not affected by past dividend distributions. Findings further indicate that tax liabilities, unrealized gains/losses, and managerial tenure explain post-tax abnormal performance after controlling for investment style, market, and other known factors that explain the pre-tax performance of bond funds. The results of this article highlight the discrepancy between managed equity and bond funds in terms of performance and flow of funds after considering tax-related implications; findings indicate that results found in existing studies on tax and tax overhang effects on equity funds may not be fully applicable to actively managed bond funds.