

Accrued investment income

Functions addressed in this document:

- In NaviPlan®, what is "previously incurred investment activity"?
- How does NaviPlan calculate accrued investment income?
- How does the clients' cash flow reflect accrued investment income?
- How is the accrued investment income treated for tax purposes?

To edit investment income earned before the valuation date for all non-qualified accounts and to add information about previously paid account fees, click **Previously Incurred Investment Activity**.

Previously Incurred Investment Activity...

Enter financial data category – net worth section – accounts page

While taxes are payable on income earned, including investment income, from January 1 to December 31, most financial plans are not created on January 1. When creating a financial plan midyear, the clients will often provide midyear market values that include investment income, which has been reinvested since the beginning of the year.

When creating a plan, it is important to specify a **Plan Analysis Date** on the **Modules** page (**Plan - Modules**). NaviPlan—by default—uses the plan creation date as the plan analysis date, but any date within the current calendar year can be entered. The plan analysis date is particularly important as NaviPlan bases plan calculations on this date and uses it as the default **Valuation Date** for accounts (to modify the valuation date, click **Details** on any entered account).

The accrued investment income feature in NaviPlan can be used to calculate the appropriate amount of taxable income. NaviPlan estimates the amount of investment income that has been reinvested in the client's non-registered accounts before the valuation date. In NaviPlan, the validation date defaults to the plan creation date, but this can be changed to any date within the current calendar year in **Details** for any account). All examples in this document focus on a Level 2 Plan with the average tax method selected.

In NaviPlan, what is Previously Incurred Investment Activity?

When accounts have a midyear valuation date, NaviPlan assumes that the start-of-year market value is the same as the market value as of the valuation date and does not start calculating growth on the account using its return rate until the month specified by the valuation date.

Because the investment income from non-registered accounts is subject to taxes, NaviPlan uses each account's rate of return to estimate the investment income earned on the clients' non-registered accounts from the start of the year to the month before the valuation date. The collective estimated amount, which includes all of the clients' non-registered accounts, is considered accrued investment income.

NaviPlan calculates taxes on the total investment income (both accrued investment income and the growth on the asset earned starting in the month specified in the **Valuation Date** field). While using accrued investment income allows NaviPlan to account for the taxes owed on investment income earned before the valuation date, this may affect cash flow in the first plan year. In addition, because accrued investment income is a combined amount that includes all of the clients' non-registered accounts, no amount of accrued investment income is reinvested into the accounts. Instead, only the after-tax income earned on each account since the valuation date is reinvested into the account. NaviPlan refers to this accrued investment income as **Previously Incurred Investment Activity**.

To illustrate accrued investment income in NaviPlan, we will use the **Single Asset Details** and **Itemized Cash Flow Projection** reports (available from the **Report** menu) and look at a plan with only one non-qualified account. In Example 1, the account has a January 1 valuation date and therefore no accrued investment income. In contrast, in Example 2, the account is using a July 15 valuation date and has accrued investment income.

Asset Details			Itemized Cash Flow Projection for All	
Robert's Account (Joint/Non-Reg.)			Lee	
Lee			Plan	
Plan			2013	
	Accrued Income	Market Value (Start)	Cash Inflows	
Jan	0.00	80,000.00	Investment Income	
Feb	305.33	80,305.33	Robert's Account (Non-reg.)	3,664
Mar	610.67	80,610.67	Subtotal	3,664
Apr	916.00	80,916.00	Total Cash Inflows	3,664
May	1,221.33	81,221.33	Cash Outflows	
Jun	1,526.67	81,526.67	Non-Registered Contributions and Reinvestments	
Jul	1,832.00	81,832.00	Robert's Account (Non-Reg.)	2,565
Aug	2,137.33	82,137.33	Subtotal	2,565
Sep	2,442.67	82,442.67	Total Cash Outflows	2,565
Oct	2,748.00	82,748.00		
Nov	3,053.33	83,053.33		
Dec	3,358.67	83,358.67		
End	3,664.00	83,664.00		
TOTAL		82,564.80		

Reports – Net Worth – Assets – Single Asset Details (left)

Reports – Cash Flow – Details – Itemized Cash Flow Projection (right)

Example 1: In the reports on the left, Robert's's account has a January 1 valuation date. Looking at the **Asset Details** report, we can see that the account earns a full year's worth of investment income, in this case \$3,664. Using the **Itemized Cash Flow Projection** report, we can also see that this investment income amount of \$3,664 comes into cash flow as an investment inflow.

Asset Details		
Robert's Account (Joint/Non-Reg.)		
Lee		
Plan		
	Accrued Income	Market Value (Start)
Jul	0.00	80,000.00
Aug	305.33	80,305.33
Sep	610.67	80,610.67
Oct	916.00	80,916.00
Nov	1,221.33	81,221.33
Dec	1,526.67	81,526.67
End	1,832.00	81,832.00
TOTAL		81,282.40

Itemized Cash Flow Projection for All		
Lee		
Plan		2013
Cash Inflows		
Investment Income		
Robert's Account		1,832
*Accrued Income - Interest (Robert)		1,791
Subtotal		3,623
Total Cash Inflows		
		3,623
Cash Outflows		
Non-Registered Contributions and Reinvestments		
Robert's Account (Non-Reg.)		1,282
Subtotal		1,282
Miscellaneous Expenses		
Robert's Account (Non-Reg.)		1,791
Subtotal		1,791
Total Cash Outflows		3,073

Reports - Net Worth - Assets - Single Asset Details (left)
 Reports - Cash Flow - Details - Itemized Cash Flow Projection (right)

Example 2: In the reports below, when the account has a July 15 valuation date, using the **Asset Details** report we see that the account only earns investment income for a portion of the year, totaling \$1,832. Using the **Itemized Cash Flow Projection** report, we can see that the investment income earned since the valuation date as shown in the **Asset Details** report comes into cash flow. In addition, we can see that NaviPlan has also included an estimated amount of investment income earned prior to the valuation, shown as "accrued income - interest" of \$1,791.

How does NaviPlan calculate accrued investment income?

To estimate the accrued investment income, NaviPlan calculates the investment income earned on each non-registered account in two stages.

1. Using the market value as of the valuation date, NaviPlan uses each account's rate of return to estimate the investment income earned for each non-registered account from January to the end of the month before the valuation date. For example, if the valuation date is in July, the calculation covers the period from January to June.
2. NaviPlan then calculates the investment income for the remainder of the year, starting from the month of the valuation to the end of the year.

To understand how NaviPlan calculates accrued investment income, we will look at a **Level 2 Plan** created for Robert and Sarah who each have a non-registered account.

Example 3: Robert's account has a market value of \$80,000 earning interest of 4.91% and Sarah's has a market value of \$60,000 earning interest of 3.13%. Because both accounts are using a July 15 valuation date, NaviPlan estimates the investment income for six months, from January to June.

Using return rates entered for Robert's and Sarah's accounts, which each have a July 15 valuation date, NaviPlan estimated the investment income earned on both accounts from the start of the year to the end of June as \$2,842. This amount is shown under **Previously Incurred Investment Activity**.

Previously Incurred Investment Activity

Enter the estimated investment income accrued before the valuation date on all non-registered accounts.

Previously Accrued Investment Income

Override

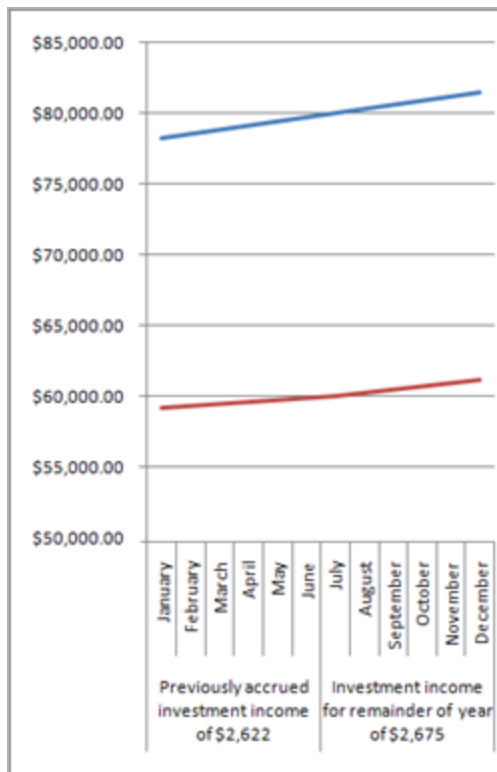
Interest	\$2,842
Dividends	\$0
Capital Gains	\$0
Return of Basis	\$0
Registered Proceeds	\$0

Include income above in cash flow

Net Worth - Accounts - Previously Incurred Investment Activity

Using MV as the market value as of the valuation date, R as the return rate, and N as the number of months prior to the valuation date, NaviPlan calculates the accrued investment income as:

$$= MV - (MV \div (1 + (R \div 12) \times N))$$



For Robert's account (the blue line), the calculation is:

$$= \$80,000 - (\$80,000 \div (1 + (.0458 \div 12) \times 6)) = \$1,790.99$$

For Sarah's account (the red line), the calculation is:

$$= \$60,000 - (\$60,000 \div (1 + (.0281 \div 12) \times 6)) = \$831.32$$

The total of \$2,622 represents the investment income earned in the months before the valuation dates, in this case January to June for both Robert's and Sarah's account.

In this graph, we can see how the investment income is accounted for throughout the year. The change in value from January to June represents the accrued investment income.

The change in value from July to December represents income earned since the valuation, which can be reviewed by generating the **Single Asset Details** report for each account.

DID YOU KNOW? If the valuation date is after December 15, NaviPlan includes a full year of accrued investment income.

How does the clients' cash flow reflect accrued investment income?

In a **Level 1** or **Level 2 Plan**, the accrued investment income is displayed and can be edited under **Previously Incurred Investment Activity**, available by clicking **Previously Incurred Investment Activity (Enter Financial Data – Net Worth – Accounts)**. While NaviPlan calculates this income for each non-registered account individually, the screen displays the collective amount by return type.

Select "include income above in cash flow" to control the net effect of accrued investment income on the clients' cash flow. The accrued investment income from the clients' non-registered investment accounts always appears as a cash inflow. A separate cash inflow appears for each type of investment return earned on the non-registered accounts. While the accounts may be owned by the client, co-client, or jointly, NaviPlan attributes the cash flow entries to the client.

By default, "include income above in cash flow" is cleared because NaviPlan assumes that midyear account values include reinvested income earned since January, which should not affect the clients' net cash flow. When cleared, the clients' cash flow shows the accrued investment income as a cash inflow with an offsetting cash outflow.

The offsetting cash outflow is equal to the total accrued income and is assigned by NaviPlan as a miscellaneous expense amount labeled "income already represented in valuation date market values". This offsetting entry ensures that the investment income earned during this period is taxed but does not affect cash flow. In plans for retired clients who are drawing income from their assets, clearing this option usually models their situation more accurately.

Looking at the **Itemized Cash Flow Projection** report, we can see the clients' cash inflows and cash outflows for the year.

Itemized Cash Flow Projection for All	
Lee	
Plan	
Cash Inflows	
Investment Inflows	
Robert's Account (Non-Reg.)	1,832
*Accrued Income – Interest (Robert)	1,917
Sarah's Account (Non-Reg.)	1,244
*Accrued Income – Interest (Sarah)	925
Subtotal	5,744
Total Cash Inflows	5,744
Cash Outflows	
Non-Registered Contributions and Reinvestments	
Robert's Account (Non-Reg.)	1,127
Sarah's Account (Non-Reg.)	845
Subtotal	2,841
Miscellaneous Expenses	1,917
*Income already represented in valuation date market values (Robert)	925
Subtotal	2,841
Taxes	
Total Taxes	1,842
Subtotal	1,842
Total Cash Outflows	6,655

Reports — cash flow — details — itemized cash flow projection

Under "investment inflows", we see "*accrued income - interest" of \$1,917 for Robert, and \$925 is from Sarah's account, which corresponds to the amount shown in the "previously incurred investment activity" dialogue box.

Because the "include above income in cash flow" option is cleared, there is no net effect on cash flow because NaviPlan creates an offsetting cash outflow.

The remainder of the \$5,744 in "total investment inflows" represents income earned by the accounts from the valuation month to the end of the year.

How is the accrued investment income treated for tax purposes?

While it is possible to control the effects of the accrued investment income on the clients' cash flow, the entire amount is always included for tax purposes.

For tax purposes, all of the investment income, that is the accrued income as well as the amount for the remainder of the year, is shown in the "income (for taxes) – investment" line in the **Income Tax Summary** report.

NaviPlan then taxes the amount at the marginal tax rate. Any taxes owing on the accrued investment income—that is, the income earned before the **Valuation Date** entered—are paid from the clients' cash flow, not from the investments.

Looking back at the **Itemized Cash Flow Projection** report, we can see that the entire amount of \$5,744, which includes the \$2,841 in accrued investment income as well as \$1,954 earned throughout the remainder of the year, is shown in the **Income Tax Summary** report as "income (for taxes) – investment".

DID YOU KNOW? While the estimate of investment income before the valuation date only applies to non-registered accounts, you can use the **Previously Incurred Investment Activity** screen for qualified proceeds received by the clients before the **Plan Analysis Date** and that are subject to tax. This is beneficial for retired clients who have taken a taxable withdrawal or closed out a qualified account in the current year.