

Keep more of your returns

As Winston Churchill famously once said, “There is no such thing as a good tax.”¹ This is particularly true when you think about how much of your investment returns are eaten away by tax.

Surprisingly many people, and indeed some fund rating agencies, focus on before-tax performance when reviewing investments. But your after-tax returns are important as they can help you maximise your potential spending power in retirement.

So how can you minimise the effect of taxes on your investment return? Fortunately, there are strategies to help you keep more of your hard-earned investment returns:

1. Keep turnover low

‘Turnover’ refers to the frequency and level of trading. The more often stocks are bought or sold, the higher the tax liability for investors.

Holding on to shares for over a year not only reduces the tax liability but also helps keep transaction costs low. Sometimes this is referred to as a ‘buy and hold’ strategy.

If you or your fund manager sells shares you’ve held for one year or less, you will pay tax on any capital gains at your marginal income tax rate. But, if you keep these assets for over 12 months, you may receive a discount of up to 50 per cent on the capital gain.²

Depending on your marginal tax rate, long-term capital gains can be more efficient than short-term realised gains because the discounted tax rate means you effectively pay less tax.

2. Invest in companies that pay fully franked dividends

When a company pays franked dividends, there is a franking credit attached to the dividends you receive.

The franking credit represents taxes already paid by a company on its earnings, which are passed on to you as the investor in the form of dividends.³ At tax time, you include your dividend and the attached franking credit in your assessable income. Depending on your marginal tax rate, you may receive a refund or owe a lower amount.⁴

While after-tax returns are important, they should not be the sole driver and you should not have to sacrifice return to gain tax efficiency. For tax aware investors interested in applying these strategies directly, or looking to purchase managed funds that apply tax effective principles, it’s important to always



consider an investment’s risk profile and its suitability.

Speak to your adviser on how to maximise your returns to suit your long term needs.

- 1 Brainquote, 2013, <http://www.brainyquote.com/quotes/quotes/w/winstonchu118762.html>, viewed 28 May 2013
- 2 Vanguard, 2013, <https://www.vanguardinvestments.com.au/retail/ret/education/inv-library/tax-effective-investment-strategies.jsp>, viewed 28 May 2013
- 3 My money calculator, 2011, <http://www.mymoneycalculator.com.au/dividends-franking-credits-explained-including-formula/>, viewed 28 May 2013
- 4 AMP, 2011, <https://www.amp.com.au/wps/portal/au/AMPAUGeneral3C?vigurl=%2Fvgn-ext-templating%2Fv%2Findex.jsp%3Fvgnnextoid%3D13d0afb267c53310VgnVCM1000008801440aRCRD>, viewed 28 May 2013