Matching Investments to Holding Structure

Investment structure is a crucial consideration when targeting efficient after-tax returns.

Holding structures include fully taxable entities and various forms of tax shelters such as charitable trusts, companies, private ancillary funds, and superannuation funds; which have different tax concessions depending on whether the fund is in accumulation or pension phase.

Matching investments to these different structures can produce significant after-tax benefits. For example:

- High income generating investments would be more appropriately placed in a lower tax structure, where regular tax liabilities from income generating investments do not occur
- The question of whether or not to realise capital gains in a tax-free structure is not influenced by tax considerations, merely by the return prospects of the investment

- All other factors being equal, high capital growth investments are best placed in a high tax environment as they produce few tax events until sold, and then often attract tax concessional rates
- Companies that are likely to buy back their shares are best held in tax-free or low tax structure where the tax benefit of the buyback can be utilised.
- Australia's superannuation system provides a powerful tax shield for investments. Placing income generating investments in these structures aids in enhancing after-tax returns . The situation is similar with capital gains realisation.

Through proactive investment matching with holding structure strategy, tax positions can be managed more effectively.

As an illustrative example, let us consider two scenarios.

In scenario 1, an investor has a personal portfolio and superannuation portfolio with exactly the same holdings, half in high yielding stocks and the other half in high growth stocks.

In scenario 2, an investor also has a personal portfolio and a superannuation portfolio. However, all the high yielding stocks are held in the superannuation portfolio, while the high growth stocks are held in the personal portfolio.

Matching Investments to Holding Structure Tabular Workings

ASSUMPTIONS		Individual	SMSF
Fully franked dividend yield	(a)	6.00%	6.00%
Capital Gains	(b)	8.00%	8.00%
Turnover	(c)	30.00%	30.00%
Realised Capital Gains	(d) = (b) x (c)	2.40%	2.40%
Tax Rate	(e)	45.00%	15.00%
Discount CGT rate	(f)	50.00%	33.33%

[1] Investment returns are enhanced through the tax advantaged superannuation structure; however certain types of returns may receive greater tax advantages than others.

		PORTFOLIO WITHOUT TAX MATCHING (SCENARIO 1)			PORTFOLIO WITH TAX MATCHING (SCENARIO 2)		
		Individual	SMSF	Combined	Individual	SMSF	Combined
High yield stocks	(g)	500,000	500,000		-	1,000,000	
High growth stocks	(h)	500,000	500,000		1,000,000	-	
Total Portfolio	(i)	1,000,000	1,000,000	2,000,000	1,000,000	1,000,000	2,000,000
Dividend before tax	(j) = (a) x (g)	30,000	30,000		-	60,000	
Franking credits	(k) = (j) x 30 / 70	12,857	12,857		-	25,714	
Tax on grossed up income	(l) = ((j) + (k)) x (e)	(19,286)	(6,429)		-	(12,857)	
Dividend after tax incl. franking	(m)	23,571	36,428		-	72,857	
Unrealised capital gains	(n) = (h) x ((b) - (d))	28,000	28,000		56,000	-	
Realised capital gains before tax	(o) = (d) x (h)	12,000	12,000		24,000	-	
Discounted tax on realised gains	(p) = (o) x (e) x (1 - (f))	(2,700)	(1,200)		(5,400)	-	
Realised capital gains after tax	(q)	9,300	10,800		18,600	-	
Total portfolio after-tax return	**(r) = (m) + (n) + (q)**	**60,871**	**75,228**	**136,099**	**74,600**	**72,857**	**147,457**

An oversimplified but typical example above illustrates an additional $11,358 in after-tax return through the tax savings achieved with effective matching of investments to the appropriate holding structure. The additional after-tax return represents a risk-free return improvement without changing any underlying investment exposures.

A variety of other scenarios can produce similar benefits, but all tax matters are highly specific to the individual.

Please contact our team for further information of PPMs service offering.

Franklin Djohan
Portfolio Manager
fd@ppmfunds.com
M: 0488 285 654
P: (02) 8256 3777