

# The taxing part of investing



Investment portfolios are generally constructed to meet your income needs, capital growth requirements and risk profile. When selecting the mix of investments to blend into your portfolio, it is important that tax is taken into consideration, as it can be the largest cost to your investment returns.

Do you know which investment would return the largest after tax amount if each of the investment types below offered an 8% distribution rate?

- Term Deposit
- Shares
- Direct Property

## Case Study

Jenny and Paul are 57 years of age and they want to reduce their working hours and want to supplement their salaries, by generating an income stream from a \$50,000 investment over a 7 year period. They are looking to invest in one of the three investment alternatives described above.

The table below shows the impact that tax will have on each of the investment options, based on the assumptions stated.

	Term Deposit	Shares	Direct Property
Annual Distribution	\$4,000	\$4,000	\$4,000
Annual Tax Payable	\$1,860	\$943	\$0
Net Income	\$2,140	\$3,057	\$4,000
Total Net Income over 7 yrs	<b>\$14,980</b>	<b>\$21,400</b>	<b>\$28,000</b>
Post tax annual return	<b>4.3%</b>	<b>6.1%</b>	<b>8.0%</b>
Net Capital Value	\$50,000	\$50,000	\$43,490
Total Net \$ Returns	<b>\$64,980</b>	<b>\$71,400</b>	<b>\$71,490</b>
Total After tax returns	<b>30.0%</b>	<b>42.8%</b>	<b>43.0%</b>

As you can see the difference in net income (after tax) can be significant, with the Direct Property delivering almost twice as much as the Term Deposit, despite both having the same gross distribution rate. This could make a big difference to your lifestyle if your investment income was used to fund your day to day expenses.

However, over the entire life of the investment there is a difference in the net capital value returned from the investment. The direct property investment reduces by \$6,510 in capital gains tax due to the deferred tax component on the income, reducing the cost base of the investment. Despite this, the Direct Property investment overall returns a marginally better after tax result than shares and substantially better than term deposits.

Investment Amount:	\$50,000
Investment Term:	7 years
Distribution Rate:	8%
Capital Growth Rate:	0%
Marginal Tax Rate:	46.5%
Franking Level (shares):	100%
Tax Deferred (property):	100%

## Understanding the tax treatment

The difference in tax treatment is due to the benefit of franking credits for shares and tax deferred amounts attributable to property investments. Franking credits occur when tax has already been paid at the corporate rate by the company paying the franked dividend (30%), allowing investors to benefit from the tax already paid. Tax deferral from property distributions occur generally from building allowances and depreciation allowances. The amount of tax deferred distributions received reduce the cost base of a Unitholder's Units in the Fund and therefore increase the amount of the capital gain on disposal of that investment. However, if the relevant asset is held for more than 12 months an investor is generally entitled to a discount on the capital gains tax and for an individual investor only 50% of the capital gain is taxed at the investor's marginal tax rate.

Tax deferral has two clear benefits:

1. It provides greater cash flow during the investment term, and
2. At the end of the investment term, provided the investment is held for longer than 12 months, discounted capital gains applies reducing the tax payable at that time.

This table shows the total investment return of not only the 8% distribution rate, but also the effect of a 5% capital growth on each investment and the impact of reinvesting the after tax income.

As Jenny and Paul may be on a different tax rate at the end of the 7 year investment term (eg due to retirement), the table shows the after tax value of each investment based on marginal tax rate of 46.5% during the investment term, but various tax rates in the year that the investment is redeemed.

	Term Deposit	Shares	Direct Property
Total Net Return @ 46.5%	\$87,664	\$98,852	\$101,906
Total Net Return @ 31.5%	\$89,404	\$100,693	\$106,979
Total Net Return @ 16.5%	\$91,144	\$102,534	\$112,051

The different tax treatments applying to each investment type provides opportunities for you to better plan your investments to suit your anticipated life stages, earning expectations and thus marginal tax rate position.

It is important to note that the after tax outcome in the above case study are specific to the assumptions used. Your circumstances may be different and you should speak to your financial adviser before investing.

## Abacus Diversified Income Fund II

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- with automatic CPI indexation
- and 100% tax deferral in FY2010 and FY2011
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- with no management fees until 110% of capital is returned
- All underpinned by property assets and underwritten by Abacus Property Group



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An offer document for Abacus Diversified Income Fund II dated 24 December 2009 is available from [www.abacusproperty.com.au](http://www.abacusproperty.com.au). Anyone considering an investment in Abacus Diversified Income Fund II should consider the offer document in deciding whether to acquire Abacus Diversified Income Fund II securities. Applications can only be accepted for this investment on the application form attached to the offer document. Issuer: Abacus Funds Management Limited ACN 007 415 590; AFSL: 227819.