



Tax Aware Investing

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Mind the gap... headline returns are not consumable returns.”





Challenges in after-tax performance

Australian investment managers do not generally report on managing investment portfolios to maximise after-tax returns. Investment portfolios are often managed to report on a headline (pre-tax return) which does not necessarily reflect consumable returns in the hands of investors.

Managing for after-tax returns remains a challenge for many fund managers given their investors have different tax positions. For example, individuals, superannuation funds and companies have different tax rates and different tax treatments apply. Compounding this, different investment strategies deliver different tax outcomes, that may or may not suit the ultimate investor's individual tax status.

Investment returns and investment costs are two key factors that investors tend to focus on. But another critical factor is often overlooked - the impact of tax.

Australia has one of the world's highest personal tax rates, and personal tax revenue accounted for 39% of all tax revenue collected in Australia – above the OECD average of 24% in 2021.¹

Tax is often the biggest cost for investors, and investors can feel very limited by the strategies available to reduce that cost. However, the impact of tax isn't tomorrow's problem.

A tax aware approach to investing connects the dots and can reduce the impact of tax by pro-actively managing to reduce tax using a range of implementation strategies. In many cases, these strategies may also help in lowering transaction costs.

The reward for investors is higher after-tax returns without taking on additional investment risk. As less tax means more to invest, the tax savings compound over time, helping investors reach their financial goals sooner.

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It's time to close the gap - Generation Life can boost the after-tax returns you keep.”



Bracket creep

The impact on personal tax liability

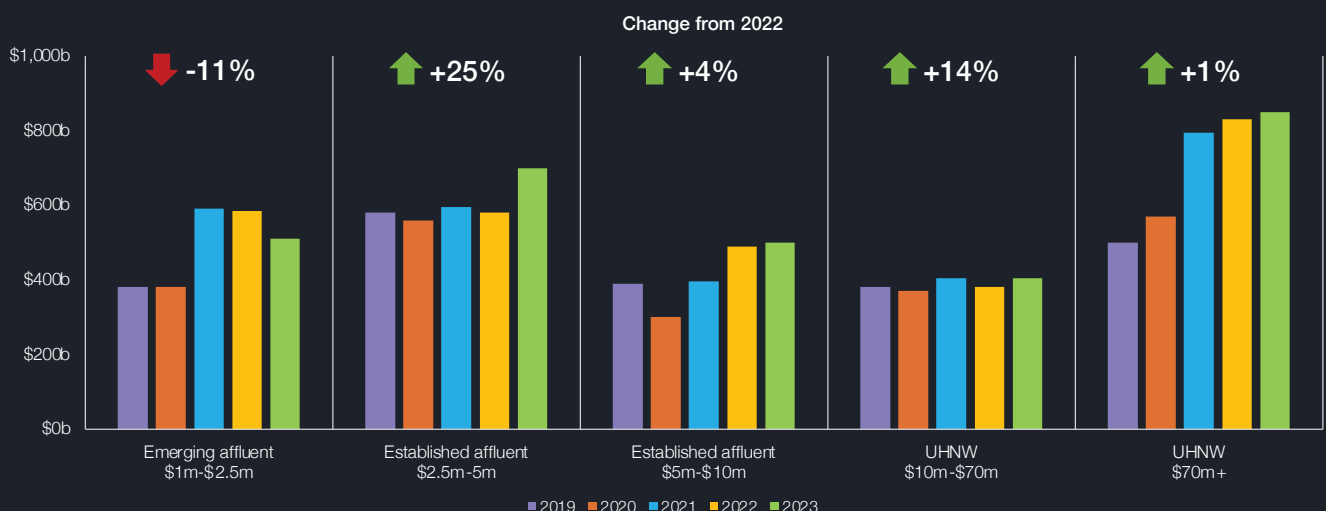
Australia's High-Net-Worth investor segment continues to grow with more than 635,000 individuals holding nearly \$3 trillion in investable assets.² Furthermore, it's estimated that one million Australians could face the top marginal tax rate by 2030 (a tripling in numbers from 10 years ago)³. With marginal tax rate levels not keeping pace with wages growth, individuals may find themselves pushed into higher marginal tax brackets and paying more tax sooner than expected.

Bracket creep has been an ongoing concern for Australians over many years, particularly given marginal tax rate tiers are not automatically indexed to keep up with inflation and wages growth.

Recent changes to personal tax rates have put a sharp focus on managing tax bracket creep, with investors exploring tax-efficient investment structures to help mitigate the impact of future tax bracket creep. Superannuation still remains a highly tax-effective way to save for retirement for most Australians, offering concessional tax treatment of contributions and favourable tax rates on earnings within the structure.

It's essential however, to note the evolving legislative landscape, such as the proposed Division 296 tax on earnings on large superannuation balances requiring careful consideration in financial planning strategies.

Trend in total level of investable assets among High-Net-Worth investors (\$b)



Source: Praemium Advising Australia's Affluent Investors 2023, <https://www.praemium.com/news-insights/australia-s-high-net-worth-investors-are-richer-but-reluctant-to-take-advice-for-key-financial-needs-research-shows/>, accessed 4 July 2024



Comparing tax paid and non-tax paid investment structures

Tax paid structures

Includes superannuation funds and investment bonds



STRENGTHS

- Income levels are assessed and tax is paid within the structure*
- Can monitor and manage tax positions based on the tax status of structure
- Tax provisioning within the structure provides for fairer tax outcomes between all investors
- Generally provides access to multiple investment asset classes
- Do not distribute income as unplanned assessable income payments for investors
- Can be protected from creditors in the event of bankruptcy of the investor
- May be structured for intergenerational wealth transfer as a non-estate asset



CONSIDERATIONS

- The effective tax rate of the structure compared to your personal tax circumstances
- Some structures such as superannuation have limited access to funds and limited ability to contribute concessional
- Tax-effectiveness varies depending on the level of tax optimisation within the structure

*Within 10-year advantage period as explained in the product's PDS.

Non-tax paid structures

Includes unit trusts, exchange traded funds, managed funds, investor directed portfolio services and direct listed share ownership



STRENGTHS

- Widely used and understood
- Tax assessable based on the status of the investor
- Provide access to multiple investment asset classes
- Can be beneficial where investor is on low marginal tax rate status

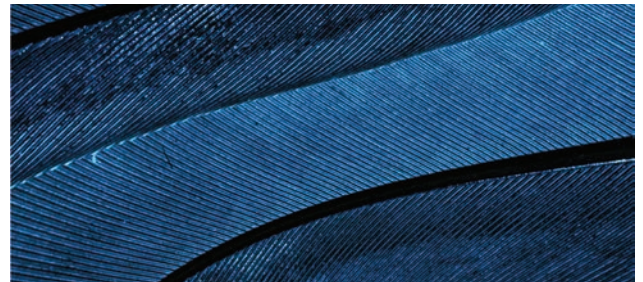
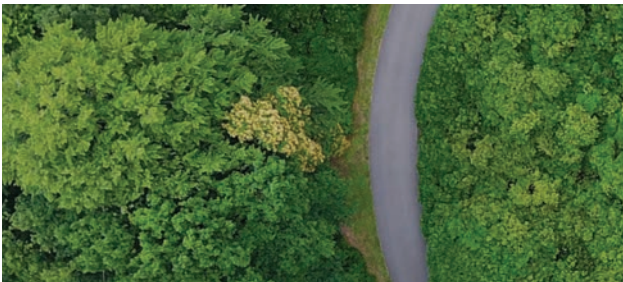


CONSIDERATIONS

- Bracket creep - lack control of assessable income received, such as dividend and distributions received
- Typically will not be tailored specifically to investors with differing tax statuses
- Estate planning and creditor protection limitations compared to a tax-paid structure
- Transparency of existing tax positions may be limited and results in capital contributions being distributed and taxed, or taxable income is passed on to new investors
- Additional complexity, cost and effort required for investors to manage, track and manage tax affairs

Challenges in after-tax performance

Understanding the tax treatment of various investment structures is crucial in navigating today's complex investment landscape. Below are some of the common tax structures available to investors.



Superannuation

A tax-effective structure where earnings on investments are taxed at a maximum rate of 15% with tax concessions on concessional contributions up to \$30,000 a year from 1 July 2024. If an individual's income and concessional contributions for Division 293 purposes exceed \$250,000 during the financial year, they will be subject to Division 293 tax, and may have to pay an additional 15% tax on some or all of their concessional contributions.

The non-concessional contributions cap is \$120,000 from 1 July 2024 for individuals who have a total superannuation balance of less than the total superannuation balance cap of \$1.9 million.⁵ Penalty tax may apply if an individual's caps are exceeded and not rectified.

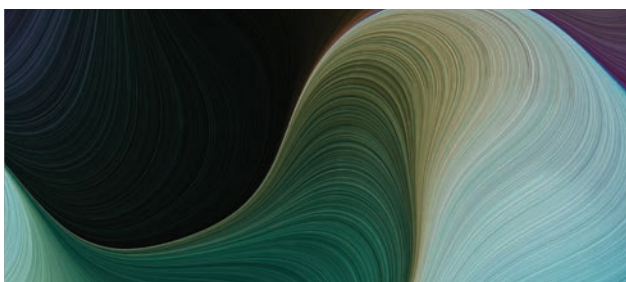
The Federal Government's proposed Division 296 tax introduces a new taxation regime, adding an additional 15% tax on 'earnings' on superannuation account balances greater than \$3 million, which can include both realised and unrealised gains. The \$3 million threshold is not proposed to be indexed.⁶

Trusts

Trusts generally distribute all income and realised capital gains each year to trust beneficiaries. If the trust does not distribute, then the trust itself will generally be liable to pay tax on its earnings (normally at the highest marginal tax rate).

Once a trust distributes to its beneficiaries, the beneficiaries are responsible for any tax liability associated with the distribution. While trusts do assist in effectively managing access to, and the distribution of wealth, there will be times where a trust structure may not be as tax-efficient as alternate structures.

For instance, the use of a discretionary or family trust may not be effective where the trust's beneficiaries' personal taxable income levels are at higher marginal tax rates. The use of child beneficiaries (such as grandchildren) may also not be effective given the punitive maximum marginal tax rate of 66% above the low tax-free threshold afforded to minors on income from investments.



Corporate beneficiary

A corporate beneficiary is a company that receives distributions or benefits from a trust and is taxed at a company tax rate of 30%. The corporate beneficiary may ultimately distribute its earnings through the payment of company dividends to its shareholders. It is in effect a tax deferral mechanism, as the company dividends will be assessable in the hands of the recipient of the dividends.

When a corporate beneficiary receives distributions from a trust, these amounts are typically subject to its corporate tax rate. However, if the trust distributions come with franking credits attached, the corporate beneficiary can use these credits to offset tax payable. Franking credits represent the tax already paid on the investment or by the company on its profits before distributing dividends. Franking credits avoid a double taxation of earnings.

Proper structuring is necessary to ensure compliance with tax laws and in particular anti-avoidance measures, particularly under Division 7A of the Income Tax Assessment Act 1936, which can reclassify certain payments or entitlements as dividends.

There may also be tax implications when winding up or distributing earnings from a corporate beneficiary company. A “top up” tax may be payable where there is a difference between the tax already paid at the company level and the tax payable at the corporate beneficiary’s shareholder’s marginal tax rate.



Investment bonds

Governed by life insurance and tax legislation, investment bonds are a tax-paid investment-linked life policy product designed to facilitate the accumulation and distribution of wealth. Investment bonds are internally taxed at a maximum rate of 30%, however, through the investment bond’s unique tax structure, tax optimisation can lower the effective tax paid.

Investment bonds offer more flexible wealth transfer arrangements when compared to some other structures, including superannuation. With the ability to nominate anyone to transfer ownership to as part of a succession or estate planning arrangement, and with options to restrict or otherwise manage the recipient’s access to funds, investment bonds can offer wealth transfer options across generations. With proposed changes to how earnings on large superannuation account balances above \$3 million will be taxed under the proposed superannuation Division 296 tax⁶, investment bonds can be a tax-effective alternative structure for these amounts.

Investment bonds stand out for their tax advantages, flexibility, cost effectiveness and simplicity to implement, manage and access. Investment bonds can be used as complementary solutions to trust structures. For example, an investment bond (which is non-distributing, retaining earnings) purchased by a trust can help manage the trust’s distributable income (with no forced distribution from the investment and no personal tax assessable amounts to deal with). Additionally, tax assessable amounts only occur if a withdrawal is made within the first 10 years of investment, and even then, a tax offset up to 30% is available for trust beneficiaries to reduce their tax payable.

Generation Life Investment Bonds

The new generation of investment bonds

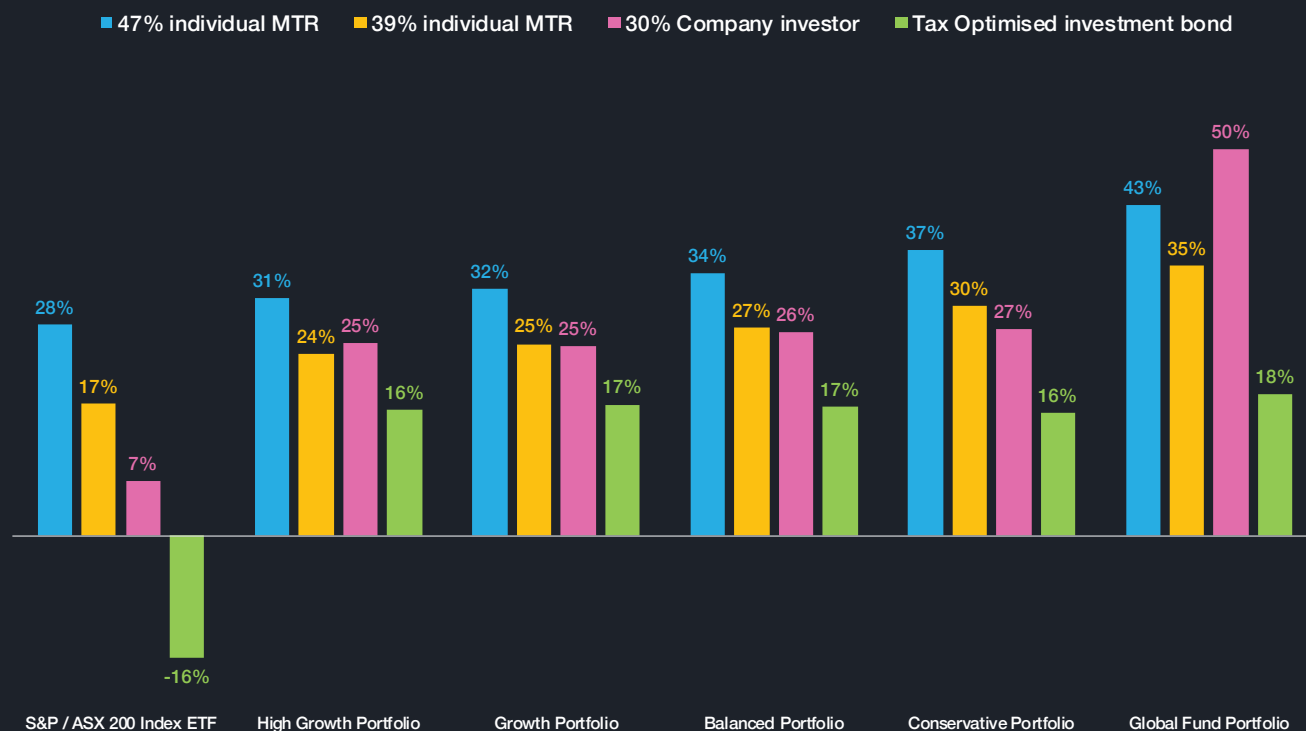
Generation Life has been at the forefront of innovating the tax-effective investing landscape through a new generation of investment bonds for over 20 years.

Generation Life Tax Optimised Investment Series

Generation Life's market leading tax aware approach can help deliver improved after-tax returns with effective tax rates of 12-15% for many of the long-term growth orientated investment options.⁷ Importantly, there is no additional investment risk. For example, the compounding effect of saving 1% p.a. due to less tax being incurred can lead to a 79.72% increased return on initial capital over the long term.⁸

After all, investment returns go up when taxes go down. It's that simple.

Example: Comparing effective tax rates for different asset classes



The table above compares the actual annual effective tax rates on the same amount of taxable distributions to different tax structures from 2019 financial year to 2023 financial year. Past performance is not an indication of future performance.



5 ways in which Generation Life can reduce the cost of tax on investments

1.

Efficiency when allocating tax parcels

Optimising the selection of parcels when trading to achieve the most beneficial tax outcome.

2.

Capital management

Reducing earnings that are tax assessable. Unlike individual taxpayers, superannuation funds and companies, investment bonds use special rules to help reduce tax assessable earnings. With an investment bond, capital losses generated can be used to reduce the level of assessable income that will be taxed in the same financial year.⁹ As a result future tax benefits can be utilised earlier. We do not need to wait for future capital gains to unlock tax benefits in the future. This also has a compounding benefit.

3.

Income management

For relevant Australian share portfolios, we manage the timing of share disposals to meet the 45-day holding rule to be able to benefit from any franking credits and to reduce the level of tax incurred by the portfolio.

4.

More control over tax outcomes

Where possible, we will hold investments (such as shares) directly rather than through a pooled structure (such as a managed fund). This means that the investment bond will not be impacted by the tax consequences arising from other investors buying or selling in the same pooled structure.

5.

Operational efficiencies

When managing the underlying investment holdings, we aim for the investment parcels that can deliver the best tax outcomes. This includes by netting of trades to reduce the impact of tax and transaction costs where appropriate.

Case study 1

Avoiding the proposed Division 296 superannuation tax

Meet John...

John is a surgeon in his mid 60s with an SMSF valued at \$5 million and is not subject to preservation.

He is married and has two kids in their mid 20s.

John's situation...

Due to the recent proposed changes to superannuation tax for earnings on total superannuation balances over \$3 million, John's financial adviser proactively contacts him regarding these changes and recommends John restructure his superannuation.





John invests \$2 million in an investment bond and has \$3 million remaining in superannuation...

	\$5m invested under current super rules	\$5m invested under proposed super rules	\$3m invested under proposed super rules	\$2m invested in investment bond
Gross value	\$5,436,238	\$5,436,238	\$3,261,743	\$2,164,023
Large balance tax	-	-\$29,324	-\$3,150	-
Net value after 12 months	\$5,436,238	\$5,406,913	\$3,258,593	\$2,164,023
Net value after 15 years	\$17,734,817	\$15,806,320	\$9,870,884	\$7,853,890
Total net value after 15 years	\$17,734,817	\$15,806,320		\$17,724,774

John's outcome...

An investment bond is an easy, convenient and cost-effective way to pass on wealth.

Each investment bond can be transferred using Generation Life's Future Event Transfer arrangement tax-free as part of John's early estate planning wishes to his children. John has access to funds whenever he needs them in the meantime and can set up tax-paid regular withdrawals before his passing.

John's children will not have any tax assessable income to declare on withdrawals after 10 years of John's original investment.

Assumptions: The table above compares investment strategies held through a Generation Life Investment Bond against the same investment strategies held through a superannuation fund over a 15-year period returning 8.45% p.a. before tax with a franking level of 81.40%, an income return of 4.83% p.a. and growth return of 3.62% p.a. and allowing for additional tax under the proposed changes contained in Treasury Laws Amendment (Better Targeted Superannuation Concessions and Other Measures) Bill 2023 and Superannuation (Better Targeted Superannuation Concessions) Imposition Bill 2023. Returns are based on historical investment returns and expected tax assessable amounts without taking into account fees, charges and expenses. Generation Life does not make any guarantee or representation as to any particular level of investment returns. Past performance is not an indication of future performance. The above is factual information for illustration purposes only based on information current at preparation and is subject to change. It is not intended to imply any recommendation or opinion about superannuation products or superannuation investments. It does not consider the investment objectives, financial situation or needs of any person. Professional advice should be sought.

Case study 2

Minimising the impact of bracket creep

Meet Tim and Sue...

Tim is a medical professional and married to Sue. Both Tim and Sue are in their mid 40s.

Tim and Sue have...

Tim's income of \$500,000 p.a. with \$5,000 per month of disposable income.

3 investment properties all in Sue's name.

Sue currently has combined salary and investment property income of \$150,000 p.a..

Tim and Sue's current situation

Sue's total income (salary and investment property income) is projected to push her into the highest tax bracket of 47% (including Medicare levy) in year 6.

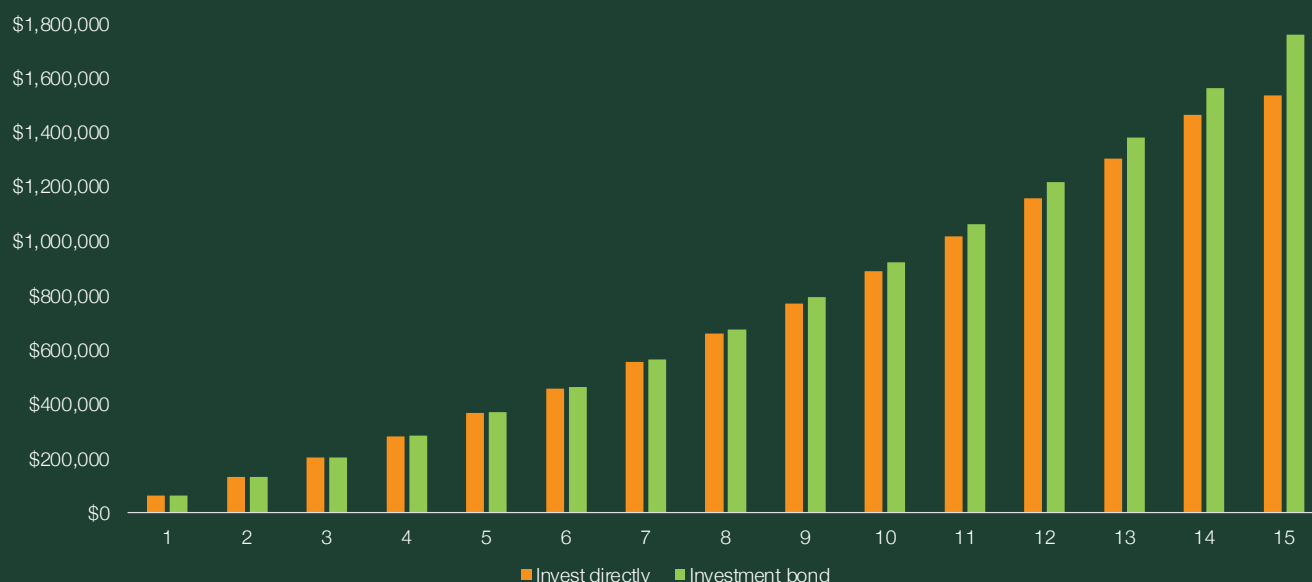




Tim and Sue's solution...

Investing in an investment bond minimises the impact of the investment on her personal tax with no assessable income distributed by the investment bond to push her into the higher tax bracket.

Sue's tax savings and their compounding effect provides an additional return benefit to her of **\$222,773 after 15 years**.



Tim and Sue's outcome...

Investment bonds are 'tax-paid' investments where tax on the investment bonds' earnings is paid within the structure, rather than personally by Tim and Sue at their personal marginal tax rate.

Tim and Sue are also able to access their investment before preservation age to transition to retirement earlier or use the investment bond to transfer their wealth to further generations with certainty.

Assumptions: Investment of \$5,000 per month made into the Vanguard High Growth Portfolio strategy over a 15-year period returning 9.5% p.a. before tax with a franking level of 90.6%, an income return of 3.0% p.a. and growth return of 6.5% p.a. Average return calculated using tax components and return history of the strategy from 1 July 2013 to 30 June 2023. Discounted realised gains of 56.6% on growth return is assumed. PAYG and assessable property related income indexed at assumed inflation rate of 3% p.a.. Performance is net of fund taxes, investment management fees and other operating expenses (if applicable) and excludes the effect of any investor specific costs, personal taxes on sale of assets or management fee rebates. Past performance is not an indication of future performance.

Case study 3

Transitioning to retirement before preservation age

Meet Jeff...

Jeff just turned 50 and would like to transition to retirement in 5 years' time.

Jeff's situation...

Jeff is currently earning \$180,000 per annum and has paid off his home loan.

He is currently maximising his concessional contributions into superannuation.

He's also accumulated \$50,000 in his bank account and has \$3,000 per month in surplus income.

Jeff's objectives

Jeff would like to work part time from the age of 55 and will need additional income to provide for his lifestyle. He's worked out that he'll need around \$6,000 per month from year 6 to 10 until he accesses his superannuation.

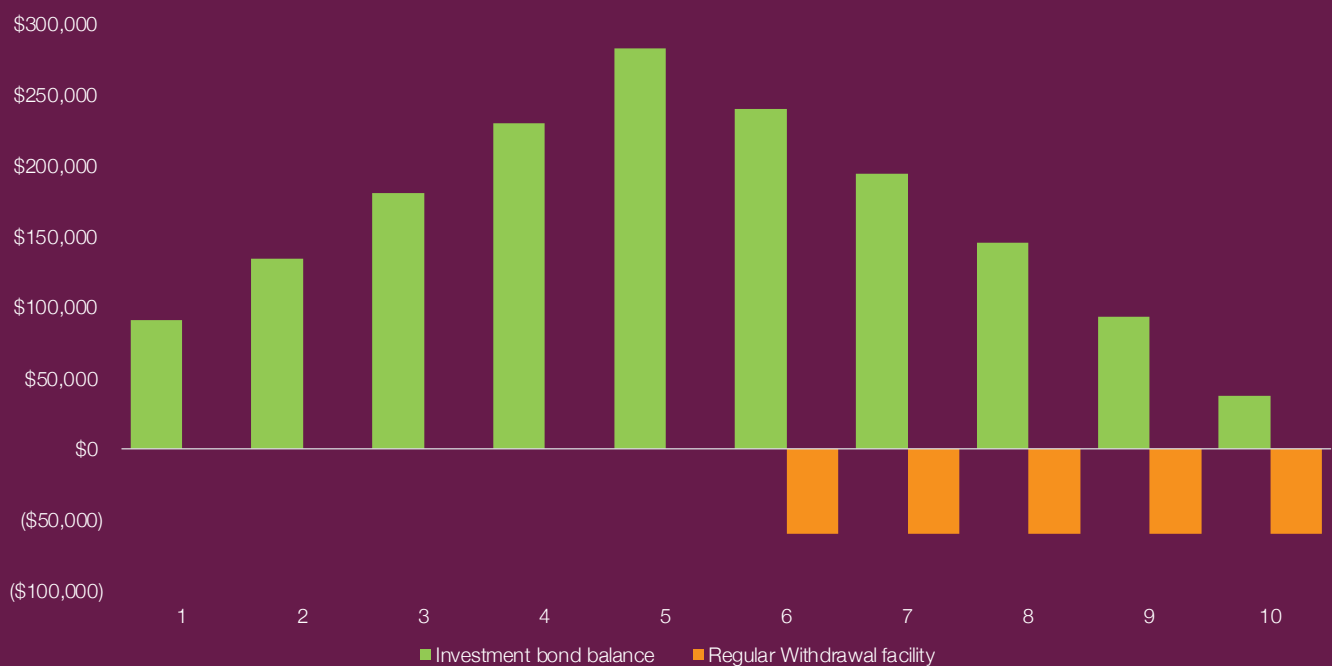
He estimates that he'll be earning \$1,000 per month from working part time and will need an extra \$5,000 per month.





Jeff spoke with his financial adviser...

Jeff's financial adviser recommends he invest \$50,000 plus a Regular Savings Plan of \$3,000 per month into an investment bond during years 1 to 5. He then sets up a Regular Withdrawal facility of \$5,000 per month from year 6 to 10.



Jeff's outcome...

Jeff is able to transition into retirement while preserving his superannuation until after he's 65 years old.

Due to Jeff being on a lower marginal tax rate, he will also receive a tax offset of \$6,514 over the 5 years, to reduce tax payable on his other income.

Jeff has access to his investment at any time, giving him the flexibility to transition into retirement at any time if he wishes to.

Assumption: Assuming an initial investment of \$50,000 plus a Regular Savings Plan of \$3,000 per month during years 1 to 5 and a Regular Withdrawal facility of \$5,000 per month between years 6 and 10. The total annual after-tax investment return of 6.83% p.a. Estimated average fees and costs of 0.67% p.a. over investment term with an effective long-term bond tax rate of 11.86% p.a..

About Generation Life

At Generation Life, we know that finding the right investment partner is important for your future success.

We've been helping Australians since 2004 across all life stages and across multiple generations. Today, we are a pioneer in providing market-leading investment bond and investment-linked lifetime annuity solutions to help secure the financial future of many Australians and their families.

As part of an ASX listed company, we're passionate about innovating and providing the best outcomes for our investors. We believe in putting our investors at the heart of everything we do.



Outthinking today.

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Sources:

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2. Praemium Advising Australia's Affluent Investors 2023, <https://www.praemium.com/news-insights/australia-s-high-net-worth-investors-are-richer-but-reluctant-to-take-advice-for-key-financial-needs-research-shows/>, accessed 4 July 2024.
3. Kehoe, J. and Read, M. One Million Australians face top tax rate by 2030, published Australian Financial Review 5 Oct 2022, <https://www.afr.com/politics/one-million-australians-face-top-tax-rate-by-2030-20221005-p5bnao>, accessed 4 July 2024.
4. Using the average annual MSCI World ex-Australia (with net dividends reinvested) in Australian dollars index return over the 15-year period to 31 March 2024. Past performance is not an indication of future performance.
5. If a person's total super balance is equal to or more than the general transfer balance cap (\$1.9 million for 2023-2024) at the end of the previous financial year, their non-concessional contributions cap is nil (\$0) for the current financial year.
6. Treasury Laws Amendment (Better Targeted Superannuation Concessions and Other Measures) Bill 2023 and Superannuation (Better Targeted Superannuation Concessions) Imposition Bill 2023
7. Estimated average tax rates being the estimated average annual tax as a percentage of earnings for each 12-month period over a period of 15 years. Actual tax amounts payable are not guaranteed and may vary from year to year based on, amongst other things, the earnings of an investment option.
8. Using the average annual MSCI World ex-Australia (with net dividends reinvested) in Australian dollars index return over the 15-year period to 31 March 2024. Past performance is not an indication of future performance.
9. Capital losses refers to losses realised on the disposal of investments that are treated as a revenue loss for tax purposes.

Disclaimer

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