UNDERSTANDING TAX STRUCTURES

In essence, selecting the appropriate tax structure ensures your investments are efficient. This efficiency comprises two major components.

Firstly, as obvious as it may sound, any investment has to pull its weight. There is no point having large amounts of money in a cheque account, as this will simply not generate the interest or capital gains that are necessary to provide you with an ongoing income.

The second consideration is that of tax. There is little point in having an "efficient" investment portfolio if at the end of the day you lose a large portion of this in tax.

Investments can operate under many different tax arrangements with five common choices; investments from two of these becoming available only after preservation age.

- The investment can be owned by:
- the individual,
- jointly (taxed as individuals),
- a trust,
- a superannuation accumulation fund, or
- an account based pension fund (also known as an allocated pension).

The major difference between these issues is taxation. After all, a BHP Group Ltd share will pay the same dividend regardless of whether the owner is a trust or superannuation fund. What differs is the tax treatment on that dividend provided by the entity.

When it comes to trusts, the income and capital gains inside the fund flow through to the owner for consideration in their tax return. This then places the individual in the same taxation position, as if they owned the asset themselves, resulting in tax at the individual's marginal rate of tax.

An individual is subject to a marginal level of tax based on their taxable income. This can be seen from the following table applicable for the 2021/22 financial year.

Taxable income 2021/2022	Marginal tax rate	Marginal tax rate plus Medicare levy
$0 - $18,200	0%	0%
$18,201 - $45,000	19%	21%
$45,001 - $120,000	32.5%	34.5%
$120,001 - $180,000	37%	39%
>$180,000	45%	47%

Assets that are invested inside superannuation (accumulation or allocated pension) funds are taxed inside the fund, at the special tax rate applying to these funds. As superannuation is the Government's preferred form of retirement savings, it receives concessional taxation treatment, as can be seen by the following table (using the tax rates for the 2020/21 financial year). This table shows the rate of tax payable inside an allocated pension fund, an accumulation fund, a Transition to Retirement Allocated Pension (TtRAP) and by an individual at marginal tax rates of 21%, 34.5%, 39% and 47%.

Type of payment	Allocated pension	Transition to Retirement AP	Accumulation Super fund	21%	34.5%	39%	47%
Franked income	(42.9%)[1]	(21.4%)	(21.4%)	(12.9%)	6.4%	12.9%	24.3%
Unfranked income	0%	15%	15%	21%	34.5%	39%	47%
Capital gains	0%	15%	15%	21%	34.5%	39%	47%
Discounted capital gains[2]	0%	10%	10%	10.5%	17.25%	19.5%	23.5%

1. Allocated pensions and superannuation funds are both able to claim unused imputation credits on shares. The fact that their tax rate is lower than the rate of the imputation credit means that they get back more tax than they paid. This effectively becomes a negative rate of tax.
2. When an asset has been held for at least 12 months, any gain becomes a discounted capital gain.

Clearly, you can see that the allocated pension provides the most tax effective environment for your investment funds; however, you should note that an allocated pension is not available until you reach your preservation age and meet a condition of release. Accumulation super and TtRAPs are the second most tax effective structures.

Unlike an individual, who can earn only $18,200 before losing their tax free status, an allocated pension has no limit on its earnings at the 0% rate. This compares to superannuation in the accumulation phase and TtRAPs which pay 15% tax on earnings.

Say, for example, you applied these tax rates across the board, to $10,000 of income from each type of payment. The table below shows the net result.

As the table shows, the net returns of the allocated pension are going to be superior to all other comparative forms of investing. The only way that one can argue against this, is when it comes to the first $18,200 of taxable income from an individual. However, the minute the individual earns more than $18,200, they move into the 19% tax bracket (or 21% where the Medicare Levy is payable) and the allocated pension moves to providing the better tax result.

It is this logic as to why individuals should move from the accumulation phase to allocated pensions sooner rather than later. It is true that the income paid from allocated pension funds (to you) is not tax exempt until age 60, however the amount of tax on this (taking into account the 15% tax offset available for those under age 60), compared with the tax savings on the fund itself, are mostly insignificant.

Type of Payment	Allocated pension	TtRAP	Accumulation Super fund	21%	34.5%	39%	47%
Franked income	$14,286	$12,143	$12,143	$11,286	$9,357	$8,714	$7,571
Unfranked income	$10,000	$8,500	$8,500	$7,900	$6,550	$6,100	$5,300
Capital gains	$10,000	$8,500	$8,500	$7,900	$6,550	$6,100	$5,300
Discounted capital gains	$10,000	$9,000	$9,000	$8,950	$8,275	$8,050	$7,650
Total	$44,286	$38,143	$38,143	36,036	$30,732	$28,964	$25,821

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