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On the front foot

Why investing with a clear lens on tax optimisation is the key to reaching wealth goals.

As one financial year ends and another begins, investment and tax returns are on everybody's minds.

As the old adage goes, death and taxes are the only certainties in this life. And, unfortunately for Australians, the taxes are some of the highest in the world.

In 2019, Australia ranked second among OECD member nations in terms of individual income tax payable with an average tax rate of 42%, only beaten by Denmark; the OECD average is about half this at 23%[1]. It's been like this for quite some time, too – we've ranked in the top three for 36 of the last 40 years and fourth for the other four.

Just like we learn of the compounding effect of interest on investments, taxes can also have a compounding effect – it's just not quite as nice. For instance, while investors might see big headline returns being advertised, the reality is they'll have to pay tax on that and their future returns will be diminished by the taxes they pay.

"This level of tax can take quite a big bite out of investment returns and therefore what investors actually get in their pockets," Generation Life head of products and projects Vincent Stranges says.

"The compounding effect of paying tax can be quite significant and can hold you back in terms of achieving your wealth accumulation or retirement objectives."

Data from the most recent census shows that 21.5% of the Australian population comprises Baby Boomers aged 55-74 years old, while the Financial Services Council estimates that as many as 800 Australians retire on a daily basis.

In years gone by, superannuation has served as the predominate structure for investing with tax consequences in mind and for saving for retirement. But prior to this, investment bonds – also known as insurance bonds – were the main investment vehicle, dating back to their introduction in the mid-1970s.

With superannuation going through round after round of reform, and with more likely on the cards, investment bonds are making a comeback as investors realise their efficacy as tax-effective investments that offer robust wealth transfer solutions.

"That's where investment bonds come into play, especially our new generation investment bonds where we can look to provide a tax-effective investment outcome, for retirement and beyond," Stranges says.

Tax Optimised Investment Series

"Our approach at Generation Life has been designed specifically with this in mind, looking to deliver superior after-tax outcomes."

Generation Life's Tax Optimised series is structured in such a way that the main objective is to drive down the tax payable on returns generated by the investment strategy. The options cater to a range of risk profiles and are also diverse, ranging from cash all the way through to alternative assets.

"We do that through making sure that we use the special investment bond rules, which are that we can offset capital losses against income which helps drive down the long-term effective rate of tax to levels such as between 12-15%[2], especially in our growth focused investment options," Stranges explains.

"With our disciplined tax management process, we look to sell down shares and units in our investment options to deliver the most tax-effective outcomes for investors. Importantly, we don't take on any additional investment risk in doing this, all we do is manage the tax arrangements within the options."

This comeback for investment bonds is boosted by the fact the federal government has flagged it will look to double the concessional tax rate applied to earnings on superannuation balances of more than $3 million from 2025.

"This is something that high-net-worth individuals and high-income earners will need to consider when looking at retirement and wealth transfer solutions," Stranges points out.

Demystifying investment bonds

However, uptake of investment bonds is still hindered by several common myths regarding this valuable investment vehicle.

The first myth Stranges looks to bust is that of the 10-year rule, or the idea that your money is locked up for a minimum 10 years.

"That's simply not the case at all; unlike superannuation, you can get your money out when you want," he says.

The second myth is the idea that there is limited investment choice when it comes to investment bonds.

"The reality is that there's a lot of choice these days. At Generation Life, we have an extensive range of options catering to different risk profiles and investing in a broad range of asset classes," Stranges says.

That investment bonds are inflexible is the third myth that needs busting, he adds.

"Generation Life Investment Bonds offer many facilities and options for financial advisers and their clients to use, whether it be a regular savings or withdrawal plan, dollar cost averaging, or auto rebalancing facility," Stranges explains.

"Investment bonds offer alot of investment choice, pretty much on par with platforms."

Further, Stranges says concerns around the cost of investment bonds are largely unfounded. While acknowledging that some years back investment bonds were rather expensive to use, however that's no longer the case.

"As with all things in life, cost is everything and people want to see value for money. Generation Life's investment bonds are quite competitive on cost when comparing them to other investment structures like platforms and superannuation funds," he says.

Meanwhile, there's also myths surrounding tax itself, Stranges says. In terms of what an investment bond pays tax on, one persistent belief is that tax is paid on unrealised gains. Again, this is not the case.

"Just like you and I, we only pay tax on realised gains and real income. Investment bonds are no different and only pay tax on what they realise, unlike the expected superannuation legislation where unrealised gains might be taxed; we won't have that issue," he notes.

Finally, Stranges says it's a mistake for people to believe that it's only necessary for wealthier segments of society to worry about managing tax implications. It's also wrong to assume that 'tax minimisation' and 'tax avoidance' are one and the same.

And Stranges notes that investment bonds aren't built specifically for high-net-worth individuals.

"Anyone on a marginal tax rate of 30% or above can use investment bonds to help manage their investment portfolio more tax efficiently," he explains.

"So, they're also for all mum and dad investors looking to make the most of their savings and reduce the level of tax that they pay, but also making sure that they control their investments for their retirement and to pass on to the next generation." **FS**

The quote

Our approach at Generation Life has been designed specifically with this in mind, looking to deliver superior after-tax outcomes.

Watch the video on www.fsitv.com

1. Revenue Statistics in Asia and the Pacific: Key findings for Australia, OECD, 2022

2. Capital losses refers to losses realised on disposal of investments treated as revenue losses for tax purposes. Tax rates refer to forecast effective average tax rates being the estimated average annual tax rate as a percentage of earnings for each 12-month period over a total period of 15 years. Actual tax amounts payable are not guaranteed and may vary from year to year based on investment option(s).

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