PRUDENTIAL
INVESTMENT MANAGERS

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Choosing between tax-free unit trusts

Everyone should certainly take the utmost advantage of the tax breaks available from tax-free investments – even if you can't invest the maximum amount every year. However, your choice of funds should not be based solely on maximising the tax saving, but rather on maximising your *total returns after tax* over your selected time horizon. That will then influence which funds are most appropriate for you.

It's worthwhile considering listed property as part of a tax-free investment because it offers both the prospect of attractive inflation-beating returns over time and typically the most tax savings. This is because there is effectively no corporate or individual tax on the investment returns. Listed property companies (REITs) do not pay corporate taxes as long as they distribute all their rental income, which is then taxed in the hands of the investor as interest income at your marginal income tax rate. So there is no corporate tax, and you pay no income tax (at a maximum marginal rate of 45%), or capital gains tax (CGT) at 18%.

For equities apart from listed property, investing tax-free means not having to pay either the 20% dividend withholding tax (DWT) or CGT. DWT is normally withheld from your dividends before they are paid to you, and the company will already have paid 28% corporate tax on its net profits before paying shareholders. This is why holding equities in a tax-free unit trust is somewhat less tax-advantageous than listed property. However, both offer excellent diversification and the highest prospective returns, thereby maximising the potential of compounding your tax-free returns over the longer term.

On face value, bank deposits or other cash-type holdings offer relatively high tax savings. The interest you earn on cash and bonds is subject to income tax (at a maximum marginal rate of 45%). However, don't forget that you already get a tax exemption on interest income every year – R23,800 if you're under 65 and R34,500 if you're older. And cash investments typically earn returns of only 1-2% p.a. above inflation, so re-investing and compounding these returns over time is much less powerful than equities or listed property, which generally return 6-8% p.a. above inflation.

Tax-free offshore funds are suitable options for investors with relatively high offshore exposure requirements. Under the tax-free regulations, although you will have to pay all taxes (CGT, DWT and tax on any interest and other investment income) to the appropriate foreign tax authorities where necessary, you then won't be liable for any of these taxes due to SARS over and above this. In non-tax free offshore vehicles you would still have to pay SARS.

This makes tax-free offshore funds an excellent way to raise your foreign exposure, especially if you have already taken advantage of the tax benefits under your full retirement annuity allocation (subject to the 30% offshore limit), Or, for example, if you are a member of a company retirement fund which has no offshore holdings, this is a tax-efficient way to diversify your total portfolio.

Prudential has recently added three of our rand-denominated global feeder funds as tax-free options for investors: the Prudential Global Equity Feeder Fund; the Prudential Global Balanced Feeder Fund; and the Prudential Global Inflation Plus Feeder Fund. These funds are managed by a large and experienced team at Prudential's

London-based parent, M&G Investments, part of the global Prudential plc group.

Don’t forget that the deadline for topping up your tax-free investment for the 2018/19 tax year to the R33,000 annual limit is 28 February 2019. Prudential offers a range of tax-free unit trusts to suit a variety of risk and return requirements. For more information, contact your financial adviser or our Client Services team on 0860 105 775 or at query@prudential.co.za.

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