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Prudential Investment Managers
MARCH 2018

Investing and taxes: What you need to know

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For all investors, especially if you're making investment decisions on your own, it's important to know what taxes you'll be incurring when you decide to invest. Unfortunately, everyone must pay tax if they earn money from their unit trusts. Luckily, the government does offer some annual exclusions to your investment earnings that are worthwhile taking advantage of. Read on to learn more about the different taxes you are likely to incur when you invest in unit trusts.

Different investors, different taxes

There are a number of taxes investors will have to pay when they earn money on their unit trusts, of which the most notable are tax on income (whether this is income from interest, dividends or listed property) and capital gains tax (CGT). The impact of these taxes will differ according to each investor's own circumstances and the underlying assets being invested in - this includes the investment vehicle and type of unit trusts.

The actual tax you pay is dependent on a combination of factors, the main two being: 1) your own marginal income tax rate; and 2) the type and amount of income and capital gains you earn in your selected unit trust funds. Obviously, the higher your marginal income tax rate, the more tax you will pay. And importantly, you are also taxed according to your unit trusts' sources of income, as shown in the below table.

Asset classes and sources of return:

Asset Class	Interest Income	Dividend Income	Property Income
Equity	No	Yes	No
Property	No	No	Yes
Bonds	Yes	No	No
Cash	Yes	No	No

Interest income

If you own bonds or cash in your unit trust, you will incur tax on the interest income they pay out. This interest income is subject to income tax, and is taxed at your marginal tax rate. Individual taxpayers enjoy an annual exemption on all South African interest income they earn, set by SARS every year. For both 2018 and 2019, this exemption is R23,800 for individuals under 65 years old and R34,500 for individuals 65 years and older.

Dividend income

For equities (excluding listed property companies), you will incur dividend withholding tax (DWT) on the dividend income they pay out. DWT of 20% is withheld from your dividends before they are paid out or reinvested. Note the DWT is payable only on dividends paid out by the companies, and is payable after the company has already paid 28% corporate tax on its net profits.

Property income

Meanwhile, the tax regime associated with listed property companies in the form of Real Estate Investment Trusts (REITs) is more complicated than other asset classes. REITs are taxed differently to other listed companies: they do not pay corporate income tax, and their investors do not incur DWT on the distributions they pay out. Instead, investors pay income tax on the distributions they receive from these REITS at their marginal income tax rate.

For this reason, higher income earners (those above the 20% income tax bracket) will pay more tax on their REIT shares than on non-listed property shares, since they pay at their marginal income tax rate and not CGT at 20%.

What about capital gains tax?
CGT is another tax associated with investing in unit trusts. A capital gains event is triggered only when you decide to sell (part or all of) your investments (such as units in a unit trust). If the price of the units has risen since you invested, this increase in value is known as a capital gain (or a capital loss if the value has declined). Currently, only an amount of 40% of this capital gain (not the total gain) is included in your annual income; this makes the maximum CGT rate for individuals paying the maximum 45% marginal tax rate 18%. Note that for 2018 and 2019, individual taxpayers enjoy an annual capital gain exclusion of R40,000.

Benefits of tax-free unit trusts
Investors in tax-free unit trusts pay no local taxes, including that on income, DWT or CGT And, when it comes to tax savings, holding listed property in a tax-free unit trust is particularly beneficial compared to other assets, since there is effectively no corporate or individual tax on the investment returns.

A note of caution, however: foreign taxes are still payable on tax-free investments. So if any of your unit trusts are holding foreign shares, bonds or cash you will still be liable to pay these associated taxes.

To see how much you could save on a tax-free investment, use our tax-free calculator. To invest with Prudential, contact our Client Services team on 0860 105 775 or at query@prudential.co.za.