The Importance of Tax Efficiency in Investment Returns:

A Message from Ian Groenewald, CEO of TBI Investment Managers

The truth about tax-efficient investing

One of the most frequently asked questions from advisers and corporates our team gets is "what makes our Sanlam funds more tax-efficient, and why?"

The answer to this question is that the Sanlam Alternative Income Fund (SAIF), the Sanlam Diversified Income Fund of Funds (SDIFOF), and the TBI Global Multi-Asset Income Fund (TGMIF) are meticulously structured to harness sources of return that are inherently more tax-efficient than traditional interest income for discretionary funds.

SAIF, SDIFOF and TGMIF focus predominantly on generating returns through dividends and capital growth. The dividends are sourced from variable rate redeemable preference shares issued by prominent banks and highly rated financial institutions in South Africa. These preference shares provide a stable, reliable dividend flow, crucial for maintaining the funds' tax efficiency. Capital Growth in SDIFOF is derived from its strategic allocation to a variety of large income funds, domestically and globally, each with complementary strategies. This diversifies risk but also creates more favourable adjusted returns to our investors.

However, the answer to the question above needs more unpacking because it belies a more disconcerting attitude that some investment advisers have about asset allocations, and by extension, their clients. What do I mean by this?

International trends in disclosing after-tax returns

In many countries, particularly in the United States, the push towards transparency in investment returns has led to significant regulatory advancements. The U.S. Securities and Exchange Commission (SEC), for instance, mandates mutual funds to report after-tax returns in their prospectuses. This initiative ensures that investors have a clearer picture of what they might actually retain after tax liabilities, fostering a more informed investment decision-making process.

The South African Context

Treating Customers Fairly (TCF) stands as a cornerstone regulatory framework established by the Financial Sector Conduct Authority (FSCA). It operates on the premise of delivering specific fairness outcomes for financial customers through an outcomes-based regulatory and supervisory approach. Within this ethos, it is imperative that financial advisors adopt a proactive stance, particularly in disclosing both pre-tax and after-tax returns on discretionary investments. This transparency underscores the intricate impact of taxation on investment returns, empowering clients with comprehensive insights into their financial decisions. Our dedication to TCF not only adheres to international best practices but also underscores our unwavering commitment to treating clients with the utmost fairness and transparency.

Why This Matters

TBI's strategic focus on dividends and capital growth over interest income significantly reduces the tax burden on returns because dividends and capital gains typically enjoy lower tax rates compared to interest income for high-net-worth individuals, trusts and companies with discretionary money. This approach significantly enhances the net returns for our investors.

Imagine a scenario where two funds both boast a pre-tax return of 8.04%. However, due to distinct asset allocations, a Sanlam fund, like SDIFOF, could potentially deliver a markedly superior after-tax return compared to an interest-bearing fund. This hypothetical scenario vividly demonstrates the tangible impact of taxes on investment returns, emphasising the critical necessity of disclosing after-tax returns. By prioritising tax-efficient sources of income, we actively strive to secure higher proportions of earned returns for our investors.

Let's break down the 8.04% pre-tax return scenario, working on the assumption that an individual/trust invested R10 million with a 45% tax rate, 20% dividend withholding tax, and 18% effective capital gains tax. The annual interest exemption is exhausted and no CGT exclusion applied.

Product name	Sanlam Diversified Income Fund of Funds (A2) 6 month rolling average 31 March 2024	Interest-bearing fund
Total returns after fees (pre-tax returns)	8.04%	8.04%
Interest	0.69%	8.04%
Dividends	1.60%	0.00%
Capital Gains Tax	5.75%	0.00%
After-tax returns (incl CGT)	6.32%	4.42%
***Pre-tax equivalent return**	11.49%	8.04%

* Pre-tax equivalent return is the amount of interest an investor would have to earn to achieve the equivalent total return (after-tax). Pre-tax equivalent return is calculated as After-tax returns (including capital gains tax) / (1 - Income tax rate).

The benefits of disclosing after-tax returns are manifold:

- **Transparency:** Provides investors with a transparent view of their net earnings, reducing surprises related to tax impacts.
- **Comparative Analysis:** Enables investors to compare different investment options based on what they actually get to keep, rather than just gross returns.
- **Strategic Investment Planning:** Enhances investors' ability to plan strategically, considering the tax implications of their investment choices.

At TBI, we believe that emphasising the tax efficiency of our funds not only serves our clients' best interests but also solidifies our reputation as a thoughtful and sophisticated manager. By focusing on after-tax returns, we offer clear, actionable insights that allow our investors to make more effective investment decisions.

Engage Further with Our Insights

For those interested in hearing more about our investment strategies directly from me, I invite you to watch a detailed video presentation. In this video, I explain the foundations of our investment approaches and how they benefit our clients.

Watch the video here

Conclusion

Understanding and utilising tax-efficient strategies is essential for all investors, particularly those looking to maximise their financial growth over the long term. At TBI Investment Managers, we are committed to providing our clients with the strategies that not only meet, but exceed these requirements, ensuring your investments are as profitable as they can be after taxes.