
EPISODE
424
THE TAX DRAG ON
YOUR RETURNS
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The Pre-Tax Illusion

50%+

More money over 20 Years

Same Starting Capital, Different Reality

Imagine two investors starting with **$1,000,000** earning **10% gross annual returns**:

• **Investor A (Tax Drag-Free):** Grows to **$6.72 Million** gross in 20 years.

• **Investor B (High Tax Drag @ 47% on income/turnover):** Keeps only **$4.31 Million** after annual tax friction.

Neither investor picked better stocks. Neither took more risk. The only difference was when and how tax was triggered.

Understanding Tax Drag

What is Tax Drag?

Tax drag is the silent reduction in net compound growth caused by paying taxes today rather than deferring them to the future. Every dollar remitted in tax today permanently reduces the capital base available to compound over future decades.

The Value of Tax Deferral

Suppose you owe $20,000 in tax on a gain:

- **Pay Today:** You lose $20,000 of productive capital instantly.
- **Pay in 20 Years:** That $20,000 remains invested, potentially growing to $130,000+ before the original tax is settled.

Not All 10% Returns Are Equal

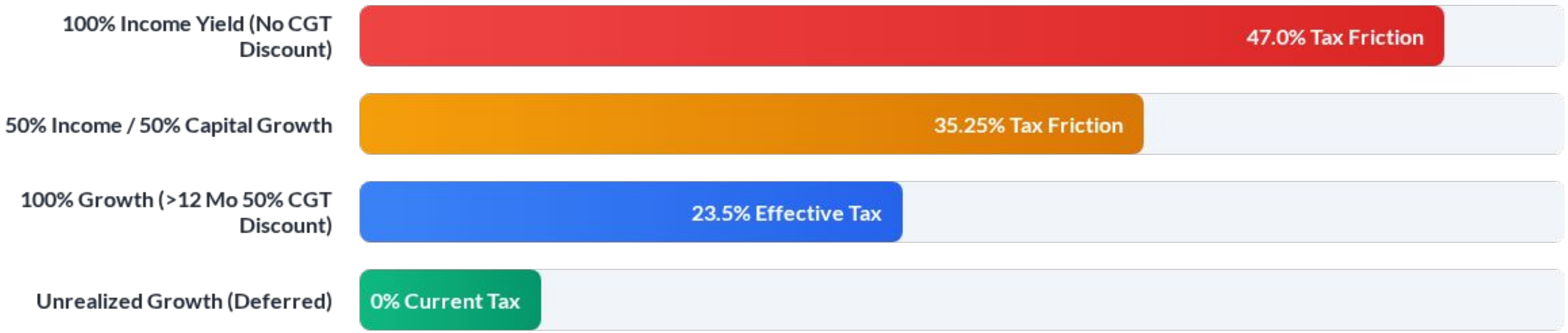
Portfolio Metric	Portfolio A (High Income)	Portfolio B (Growth Focused)
Return Composition	6% Dividends / 4% Growth	1% Dividends / 9% Growth
Gross Return	10.0% p.a.	10.0% p.a.
Annual Taxable Drag (Top Rate 47%)	2.82% lost to annual income tax	0.47% lost to annual income tax
Net Compounding Rate	**7.18% p.a.**	**9.53% p.a.**
Value on $1M after 20 Years	**$4,001,000**	**$6,142,000 (+$2.14M)**

Turnover: The Invisible Tax

Turnover Rate	Typical Strategy Type	Tax Consequence & Realization	Est. Annual Drag
5% Turnover	Direct Indexing / Buy & Hold	95% of capital gains deferred; maximum CGT discounts unlocked	~0.20% p.a.
20% Turnover	Low-Turnover Active Fund	20% realized annually; moderate capital base compounding reduction	~0.65% p.a.
50% Turnover	Standard Active Mutual Fund	50% realized annually; heavy taxable capital gains distributions	~1.5% p.a.
100% Turnover	High Active / Trading Strategy	100% realized annually; forfeits CGT discount & deferral compounding	~2.5% p.a.

Key Impact: Moving from 100% to 5% turnover preserves **over $2.11 Million** in wealth on a $1M portfolio over 20 years—without requiring higher pre-tax returns or market timing.

Dividends vs Capital Gains



Key Takeaway: High dividend yields create immediate, non-negotiable tax events. Prioritizing capital growth allows control over when tax is paid.

The Strategic Power of Timing

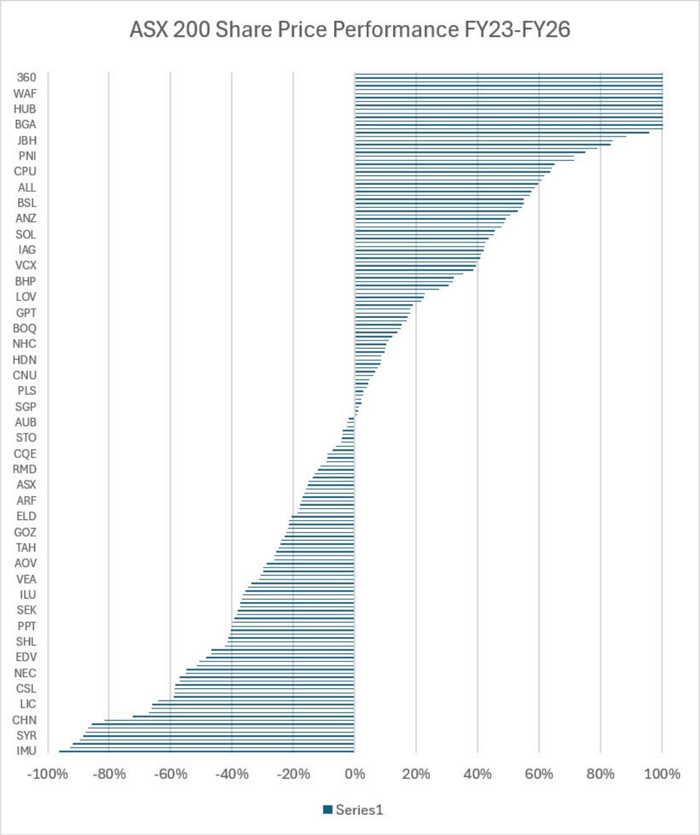
Month 11
Selling now incurs full capital gains tax (up to 47% marginal rate).

Month 12+
Qualifies for 50% CGT Discount. Max effective tax rate drops to 23.5%.

June Sale
Capital Gain realized in current FY; tax payable in upcoming tax lodgement.

July Sale
Same gain deferred to next FY; tax payable up to 12 months later.

Stock Returns are not what you think they are



ASX 200 Index

- 3 years to 30/6/2026
- 22% capital return
- 50% of all stocks had capital loss over that time period

Multi-Parcel Flexibility

- **Lump-Sum vs Dollar Cost Averaging:** A single $1.2M investment gives you 1 cost basis. Investing $10k/month over 10 years creates 120 distinct cost parcels.
- **Targeted Liquidation:** When raising cash, you choose which specific parcels to sell based on individual tax profiles.
- **Optimized Tax Outcomes:** Select low-gain or loss parcels to minimize current tax bills while preserving high-gain parcels for tax-deferred compounding.

Practical Parcel Selection

Purchase Parcel	Cost Price	Current Price	Gain / Loss per Share	Strategic Tax Impact
2017 Parcel	$22.00	$42.00	+$20.00 (Gain)	Triggers large capital gain tax bill
2026 Parcel	$39.00	$42.00	+$3.00 (Gain)	Minimal taxable gain triggered
2021 Parcel	$45.00	$42.00	-$3.00 (Loss)	Creates Capital Loss to offset gains

Case Study: Nucleus International Direct Index:

- Inception 31 Dec 2000
- $10,000 at inception = $23,940 = 140% Return
- 16% capital gains
- 11% dividends (3% foreign tax credits)

But, if you were investing $1,000 per month

- Same dividends
- You have banked a capital loss.

Tax-Aware Portfolio Management

Tax-Efficiency

Systematically realize losses on underperforming holdings to offset capital gains elsewhere across the portfolio.

Direct Share Ownership

Own the underlying securities directly rather than pooled fund units, avoiding unwanted capital gains distributions from other investors.

Controlled Turnover

Execute portfolio rebalancing with active tax controls, replacing sold positions with similar assets to maintain market exposure.

Investor-Specific Optimization

Investor Structure	Tax Environment	Optimal Tax Strategy
Working Professional (47%)	High Marginal Rate	Defer capital gains; focus on growth and loss harvesting.
SMSF Accumulation	15% Income / 10% CGT	Balanced approach; moderate sensitivity to yield vs growth.
SMSF Pension Phase	0% Tax Rate	Maximize high franked dividend yields; tax drag is non-existent.
Family Trust	Flexible Discretionary	Stream income & discounted capital gains to optimal beneficiaries.

Why Direct Indexing?

Direct indexing provides absolute control over tax lots, turnover, gain realization, and customization.

> *"Investors spend weeks comparing fund management fees between* ***0.35%*** *and* ***0.45%****, yet ignore tax drag that can exceed* ***1.50%*** *annually. Fees are printed on every PDS—tax drag isn't."*

After-Tax Wealth is the Only Metric That Matters.

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