

Senior Tax Counsel's Report

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Tax Differences: Property vs Shares

Recently, I stumbled across some figures on the historical returns from Australian shares and Australian residential property (Michael Yardley's Guide to Investing Successfully, page 220). The numbers suggest that the returns on Australian residential property (7.4%) are better than those for Australian shares (5.5%) over the 10 year period to December 2015. Over the 25 year period to December 2015, both return somewhere in the region of 10%.

This prompted me to think about the relative pros and cons of property and share investment in terms of tax. The figures previously presented are of course figures based on pre-tax returns.

Interestingly, the tax arrangements in relation to shares appears to be much more attractive than that applicable to property. In particular, assuming that there is no underlying property held by the referable company, there is no stamp duty or land tax payable on the purchase of shares in a public listed company; franking of dividends applies to shares but not to property; and deductions for interest are unaffected by negative gearing restrictions as proposed by the Federal Labor Party. On the other hand, more generous deductions apply in relation to property, although even these are being wound back by the current Federal Government.

The table below summarises the contrast:

	Shares	Property
1. Stamp Duty	No	Yes
2. Land Tax	No	Yes
3. Franking of Returns	Yes, but ALP proposes to restrict this benefit	No
4. Capital Gains on Sale	Yes	Yes
5. CGT Discount	Yes, currently 50% but ALP proposes to reduce to 25%	Yes, currently 50% but ALP proposes to reduce to 25%
6. Deductions for Interest	Yes	Yes, but ALP proposes negative gearing restrictions
7. Other Deductions	Very few	More generous, but the Coalition has restricted certain deductions e.g. travel expenses to view property/certain depreciation deductions.



To see how some of this plays out in a case study, I hypothesize the case of Betty who inherits \$1,000,000 in 2012. She could have used the money to buy, in her own name:

a) A property being a small office block in Broken Hill, NSW, which produces an annual 5% taxable return; or

b) A selection of listed company shares each paying a 5% fully franked dividend.

The returns, based on various assumptions as indicated from these two different investments is summarised below:

	Property	Shares
	\$	\$
Purchase for	(1,000,000)	(1,000,000)
Stamp duty	(40,490)	Nil [1]
Taxable income over 5 years	250,000	250,000
Tax to pay @ assumed marginal rate of 32.5% [2]	(65,747) (ie each year tax is payable on 50,000 – 9540 (land tax) @ 32.5%)	(6,250) (ie each year tax is payable being 16,250 – 15,000 franking credit)
Land Tax over 5 years [3]	(47,700)	Nil ³
Sell at end of Year 5	1,300,000	1,300,000
CGT	(42,170) (ie SD is part of the cost base so CG included is half of 259,510)	(48,750)
Net Return over 5 years	353,892	495,000

As can be seen, the overall return from the share investment is some 40% greater than what is returned from the property investment.

Of course, there are a number of flaws to the analysis:

- the 2 investments won't increase at the same rate and the returns won't be the same;
- the greater availability of deductions in relation to the property investment, have not been fully reflected in this analysis and the tax payable on the property investment will be less, having regard to the greater number of deductions which will be available in the context of the property investment; and
- the income tax stamp duty and land tax rates are likely to change over time.

Nonetheless, even recognising all these deficiencies, the general point is true - from a tax perspective, there is a clear bias in favour of shares over property. Stamp duty, land tax, and franking of dividends, provides the greatest advantages to shares over property. The significant



upfront impost of Stamp Duty inevitably means that the amount invested initially is significantly reduced when investing in property as opposed to shares.

Mr Shorten's proposal to deny excess franking credit refunds is likely to diminish the attractiveness of share investment, (at the very least temporarily) but this is likely to be matched or surpassed by the diminished interest in property that will be caused by his proposal to curb negative gearing on all but new investments in property.

It will be interesting to see how all this plays out in the run up to the next Federal election.

Kind regards,

Bob Deutsch, CTA

[1] No stamp duty or land tax on the shares as there is no property in the underlying assets of the referrable company.

[2] Marginal tax rate 32.5%

[3] For NSW Land Tax purposes UCV is \$590,000 and Betty has other property in NSW that takes her into the 1.5% bracket on this property.

NSW rates are:

0 – 629,000	Nil
629,000 – 3,846,000	\$100 + 1.5% of the excess
3,846,000 +	\$51,572 + 2% of the excess