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tax breaks encourage savings

Tax breaks on interest income introduced in the May Federal Budget will hopefully encourage more Australians to save. But it's worth remembering that other investments also deliver welcome tax savings.

From 1 July 2011, assuming it's enacted, we'll have even more of an incentive to start a personal savings plan. Instead of interest income being fully taxable, the first \$1,000 of interest earned on deposit accounts will attract a 50% tax discount.

This is a plus for savers, because without the tax break, a high income earner for example, could lose up to almost half any interest income to the tax man. Put differently, the tax concession on interest is like earning a higher return on your savings.

Tax savings of any sort are always good news however it's worth remembering that other investments like property and shares also provide tax-friendly returns.

Landlords for instance can claim many of the costs associated with holding a rental property, including mortgage interest, as a tax deduction. This helps to reduce the cost of owning the investment, and if the total of the property-related expenses exceeds the rental income,

the loss can be used to trim the tax payable on other income including wages or salary.

Shareholders can enjoy significant tax savings on dividend income. If a dividend is paid out of profits on which the company has paid tax, shareholders receive 'franking credits'. These recognise the value of tax already paid by the company, and for a middle income earner, franking credits can make dividends an almost tax free source of income.

Shares and property offer tax concessions on capital gains too. If you've held onto the investment for over 12 months only 50 per cent of any profit on the sale is taxable.

It may not be necessary to hold these investments directly to benefit from the tax concessions. Many of these tax savings flow through to investors who hold units in a managed fund that invests in shares or property.

Savings accounts and term deposits are a very secure investment so you're unlikely to lose money. However there is a trade off - generally low returns, and no capital growth. Without the latter, the purchasing power of your money will be eaten away over time by inflation. This is why you should have both income producing and growth investments in your portfolio.

Websites like www.infochoice.com.au and www.ratecity.com.au show which savings accounts and term deposits are offering the best returns at present. If you're unsure about how to get started with investments like shares or managed funds that offer long-term capital growth, visit the consumer website of the Australians Securities and Investment Commission at www.fido.gov.au - click on 'about financial products'. Or take a look at my book 'Making Money'.

Paul Clitheroe's 'Making Money' for the week beginning 26 July 2010



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