FINFLASH

DON'T MISS OUT ON **THESE TAX BREAKS**

No matter how little you earn, if you pay tax there are two products in the market which no tax payer can afford to ignore: Tax-free Savings Accounts (TFSA) and Retirement Annuities.

ADVANTAGES OF A TAX-FREE SAVINGS ACCOUNT

- **What is a Tax-Free Savings account (TFSA)?**

  A tax-free savings account is an investment where NO tax is charged on the gains (on interest, dividends or capital) made by the investment – not during the investment term and not when the investment pays out. Any money invested in a TFSA is therefore unfettered by tax and can generate maximum returns. Normally tax is payable on any gains (interest & capital gains) within an investment. This diminishes the returns.

- **Why do I need a TFSA?**

  If you are trying to save for some event in the future (such as retirement, for your children's education, a home of your own, a nest egg in case of retrenchment or huge medical expenses) it makes sense to get the best returns possible on your savings. If you save by using a Money Market account, you still have to pay tax on the interest you earn. You do have a tax rebate if the interest is low, but if you aim to save over time you will probably have to start paying tax on the interest at some stage. However, if you save in a money market fund within a TFSA, you will never pay tax on the interest. You can also choose to save in a unit trust with exposure to equities and/or with international exposure.

- **What are the Advantages of a TFSA?**

  Interest earned, dividends received and any capital gains made when the units are sold within the investment are totally tax-free. Even your withdrawals are made completely tax-free. Money invested in a tax-free savings unit trust account is accessible and can usually be withdrawn within days.

- **What are the Limitations of a TFSA?**

  Funds invested in a TFSA should ideally be invested for as long as possible, in order to benefit as much as possible from the character of this investment vehicle. Investment capital and investment returns in multi-asset unit trusts cannot be guaranteed. In order to qualify for tax-free status, a collection of unit trusts must meet certain requirements and may only invest in certain funds. There is an annual R33 000 and a life-time R500 000 limit on all contributions. If you make a withdrawal from your TFSA, that **withdrawal can never be replaced** by new investments. As with other investments there are terms, conditions and risks associated with investing in Tax Free Savings Accounts.

- **How does it work?**

  The investor buys units in the collection of unit trusts, which is held on behalf of the owner by trustees. A maximum of R33 000 per year and a life-time maximum of R500 000 may be invested in a TFSA. It allows individual investors to diversify their portfolios between different asset classes and fund managers. The TFSA is therefore very useful for those investments where tax would be generated if held in any other way (such as interest earned in money market investments or capital gains tax on value increases in direct share-holding).

If you would like to start investing in a Tax Free Savings Account

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ADVANTAGES OF A RETIREMENT ANNUITY (RA)

- ### What is a Retirement Annuity (RA)?

An RA is an investment which diminishes the tax payable on your income. If you invest in a retirement annuity, you generate tax benefits in addition to generating the retirement funds you will need in future. You invest with before-tax money, so your investment is larger. There is no tax on the growth, interest and dividends earned within the retirement annuity either. In addition, your RA contribution is deductible from taxable income, it therefore reduces your taxable income, resulting in less tax payable. The higher your income, the higher your marginal tax rate and therefore the higher the saving that you'll have in tax payable. You can invest 27.5% of your total annual income or remuneration (up to R350 000 annually) TAX FREE (without paying tax on the entire amount invested). The higher your tax rate the more your retirement annuity is subsidised by the tax advantage associated with a retirement annuity.

Example: if you have a marginal tax rate of 40%, you will save R400 in tax for every R1000 that you contribute towards a retirement annuity or other retirement fund.

- ### Why do I need a Retirement Annuity?

Why pay unnecessary tax? You have to save while you work to support yourself after you retire. It therefore makes excellent sense to combine saving tax on your current earnings at the same time as saving for retirement. You achieve both these objectives if you make use of an RA. The earlier you start and the longer you continue saving, the better off you'll be during retirement.

- ### Advantages of an RA?

◊ You pay less tax, because the contributions are tax deductible.

◊ There are no capital gains or income tax [including tax on interest and on dividends] payable on a retirement annuity investment. Growth over time should therefore be better than in a similar after tax investment.

◊ Flexibility of contribution is possible. You may decrease contributions to an RA temporarily or permanently if funds are tight. The opposite is also true. If you suddenly have more cash available (for instance, because of a bonus) your regular contribution to a retirement annuity can also be increased by doing an extra once-off contribution to your RA.

◊ The flexibility of contribution associated with a RA makes this **the investment instrument of choice for someone who is self-employed.**

- ### Further advantages:

◊ Your retirement annuity does not form part of your dutiable estate at death.

◊ Creditors cannot access your retirement annuity in event of insolvency.

◊ In addition, your estate saves on executor's fees and estate duty. This is an important way to transfer wealth, or at least a good nest egg, to beneficiaries.

- ### Limitations of a Retirement Annuity?

This investment is aimed at retirement and therefore not accessible before the age of 55 (unless under special circumstances). The exposure to asset classes in which the money can be invested is restricted - you cannot invest more than 75% of your contributions in equities and international exposure is limited to 30%.

Only one third of the accumulated capital can be taken as a cash lump sum at retirement of which the first R500 000 will be tax free and the balance taxed according to a tax table.

At least two thirds of the capital (at retirement) have to be invested in a compulsory annuity/pension at retirement that will provide you with a monthly income post retirement. This monthly income will be taxable - the rationale being that your original contributions were tax deductible and therefore untaxed.

If you want to find out about paying less tax, or are interested in investing in a retirement annuity

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