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Options: investors are spoilt for choice

South Africans are notorious for being poor savers with more of a debt culture than a savings culture and one of the lowest household savings rates globally.

To encourage a better culture of savings, in 2015 the government introduced tax-free savings accounts (TFSAs) which allow investors to contribute a maximum of R36,000 a year, with a total cap of R500,000 over their lifetime, to a tax-free savings account.

The capped amounts only refer to the capital contribution and don't include the growth on the investments which is why TFSAs are a good idea to use as a buffer to retirement savings or even an investment for children's educations, explains Thulisile Nkomo, a private wealth manager at NFB Private Wealth.

"If the funds are used as a buffer at retirement, the investor can limit the drawing on their annuity investments which reduces their tax liability," she says.

However, while there is technically no limit to the contributions made to a TFSA, contributing more than R36,000 per annum is not a good idea as any sum higher than the annual limit is taxed at 40%, says Nonnie Canham, a private wealth manager at NFB Private Wealth.

Not only do TFSAs not carry any tax charges, but they have numerous benefits including flexibility and higher returns compared to traditional investment products.

RANGE OF FUNDS

"The number of tax-free savings account options have increased significantly over time and investors are spoilt for choice," says Nkomo, adding that investors can choose to invest in money market instruments through banks, or a range of funds including equity, property, bonds and cash, as well as exchange traded funds (ETFs) either locally or globally.

"Make sure the service provider is a registered financial service provider and has a licence to sell TFSAs," she advises.

Due to the long-term nature of tax-free savings, the tax benefits, accessibility and flexibility, TFSAs are often considered as part of a retirement savings plan. Combined with retirement fund savings they are an opportunity to boost a retirement nest egg with a tax-free lump sum at retirement.

Thulisile Nkomo ... buffer.

RAs VERSUS TFSAs

Given that TFSAs are better utilised when saving for the long term, it's important to resist the temptation to make early withdrawals.

While it's certainly not a bad idea to use a TFSA account to save for a minor child, Canham maintains that a retirement annuity is ultimately a better option than a TFSA.

"The danger with a TFSA is that because withdrawals can be made at any time, parents dip into these accounts when life 'happens'. Not only does this deplete what has been saved for the child, but it uses up their lifetime contribution limit given that refunding this investment is not an option," she says.

Nonnie Canham ... TFSA and RA.

"If, for example, you invested R200,000 into your child's TFSA and you make a full withdrawal, the child's lifetime contribution limit to the TFSA is now reduced to R300,000 from R500,000, which makes it harder to achieve the benefits of compound interest."

The same, says Canham, applies if you are investing in a TFSA for your own benefit. "Ultimately, the TFSA structure should be used only with a long-term savings strategy in mind so as not to waste the lifetime contribution limit."

She says that when it comes to a long-term savings plan for a minor child, a retirement annuity is a better option as nobody — not even the child — can access the investment prior to them turning 55, unless it is valued at R15,000 or less.

When it comes to the most tax efficient structures in retirement, Canham maintains that the best long-term value is to have both a TFSA and a retirement annuity. "This way you can lower your income tax in your retirement years by drawing an income from both structures. If, for example, you require a monthly income of R50,000, you could benefit by drawing R30,000 a month from your pension or living annuity and taking the balance from your TFSA. Because the R20,000 drawn from the TFSA will be tax free, you will only be paying tax on the R30,000."

ESTATE DUTY

While TFSAs offer more control with regard to who receives the proceeds once the investor has died, this is at the expense of having to pay estate duty on the sum accumulated within the TFSA.

A retirement annuity, on the other hand, allows the proceeds to pass directly to the beneficiaries, leaving the ultimate decision regarding who those beneficiaries are to the trustees of the fund.

"It's important to know that even though the investor may have nominated beneficiaries, the trustees will do their own investigations to ascertain who was dependent on the investor and should therefore be included as a beneficiary," says Canham, adding the final decision resides with the trustees and not the investor.

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