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NEWSLETTER

Special Edition Newsletter – March 2015

NUTS AND BOLTS OF TAX FREE SAVINGS ACCOUNTS

The new Tax Free Savings Accounts (TSA) were launched on 1 March this year. We have taken a few weeks to review them so that we can provide you with a proper update on these investments. Many of our clients would like to know where they should invest their money to benefit from the TSA so we have provided some recommendations in this special newsletter.

BACKGROUND

Tax free savings accounts are savings products on which no income tax, Capital Gains Tax or dividend withholdings tax will be charged. Most unit trusts, Exchange Traded Funds (ETF), savings accounts, fixed deposits and RSA Retail Savings Bonds meet the requirements to be classified as a TSA. In other words these are not new investment products, rather the way that SARS will treat them is new and so product providers need to keep record of these to ensure that they remain separate from your other investments.

You are allowed to invest R30,000 per year into a TSA subject to a maximum lifetime limit of R 500,000. SARS will charge a 40% tax on contributions above these thresholds so please don't add more than you are allowed. If you withdraw money from the TSA, you will lose the value of that withdrawal from your lifetime limit; this means you should only use the TSA for long term investments i.e. 20 years and longer. You are not forced to keep your money in a TSA, you can withdraw at any time with no penalties or tax.

POTENTIAL TAX SAVINGS ON A TSA

According to research by actuarial firm, Simeka, an investor who pays the highest rate of income tax would save approximately R110,000 over 20 years by contributing to a TSA rather than a normal unit trust. This is because the person would save on income tax, dividends tax and Capital Gains Tax whereas the normal unit trust would not offer this benefit. Simeka's research also reinforces the point that retirement funds are still your most tax efficient investment as the person described above, would have saved R306,000 more via a retirement fund (after tax) than a TSA and R416,000 more than a normal unit trust or share portfololio.

WHEN SHOULD YOU USE A TSA?

If you were to prioritise your long term savings, we suggest the following:

1. Pay off your short term debts (credit cards, personal loans, expensive vehicle debt etc.)
2. Build up an emergency fund (not in a TSA) between three to six months' worth of your expenses
3. Make full use of your Retirement Fund contribution allowance (15% of taxable income)
4. R30,000 per year into the TSA
5. Normal discretionary savings i.e. shares, unit trusts, ETF's etc.

We believe that every young person should take advantage of the TSA as it will take more than 16 years to reach your lifetime allowance. Any parents or grandparents who want to start investments for their children should definitely use a TSA. If you are able to invest the R30,000 per year for them from the time they are born, they could have a few million when they are in their 20's, this would be a wonderful start in life for them – tax free! If a parent or grandparent takes out a TSA for a child, and the child uses this cash when they are in their 20's, then the child will not be able to make use of the TSA again, as you cannot re-use withdrawals.

Investors who are in the higher income tax brackets should also make use of a TSA because you will save on tax. The benefits of allowing the capital to grow without tax over the long term are very significant and should not be ignored just because the amounts might be relatively small.

If you are an older investor or if you are only investing your money for a short period of time, the benefits of the TSA are less obvious and you should rather discuss your options with us before making a decision on this investment.

OUR PREFERRED TSA INVESTMENTS

We have not seen all the new TSA investment products yet as some of the product providers are still in discussion with Treasury about issues such as performance fees. In the interim, we prefer Listed Property Funds for our clients' TSA. This might not suite every person's specific situation, for example if you already have a significant property exposure then you might need to consider an alternative. Please feel free to chat to us about your options before making this investment decision.

Listed property is at the top of our rankings for TSA's because their income is normally taxable and this can make them less attractive than normal shares. However, investing in listed property via a TSA means the income is tax free and this is very attractive. Most balanced funds and retirement funds are underinvested in listed property so this is a great way to gain some more property exposure. Listed property is currently very expensive, so you might consider investing via a monthly debit order to spread your purchase price over time. If you prefer to invest in shares or a balanced fund, the tax benefits are still very significant and should not be ignored.

We believe the TSA is a great innovation by Government as investors do not have many opportunities to save tax.