LEGACY

FAMILY WEALTH

Tax-Free Investment Accounts

Overview

Most South Africans are familiar with retirement accounts such as retirement annuities or pension funds but what about Tax-Free Investment Accounts? A Tax-Free Investment / Savings Account (TFSA) is a savings account that allows you to save for both short or long-term goals without paying taxes on any of the growth or income you earn. Additionally, you are not taxed on withdrawal or termination of the account – and you have instant access to your money whenever you need it.

These accounts therefore offer significant tax advantages and flexibility for individuals looking to save and invest. However, they come with certain limitations and regulations that investors should be aware of. We have therefore compiled an overview of tax-free investment accounts to explain how these accounts can be used to your benefit, including their advantages and disadvantages.

What is a Tax-Free Investment Account (TFSA)?

In South Africa, Tax-Free Investment Accounts, commonly referred to as Tax-Free Savings Accounts, were introduced in March 2015 to encourage individuals to save and invest while enjoying certain tax benefits.

Similar to a standard unit trust, TFSAs allow you to invest in top performing companies via certain unit trust funds and have the potential to generate greater returns than an ordinary bank account over the long run. Unlike a standard unit trust, you don't pay tax on interest, dividends and capital gains, which means your investment has the potential to grow faster. It is also a useful product for estate-planning purposes.

Note that the costs associated with a TFSA will depend on the unit trust funds you select to invest in as well as the provider you choose to place the account at. Some TFSAs offer a fixed or floating interest rate while others offer the ability to invest in unit trusts (collective investment schemes) so make sure that you are selecting the best account for your needs.

TFSAs give you the best results when you see them as long-term investments (as opposed to savings accounts earning an interest rate), because investors need not pay tax on the capital gains, interest or dividends, which can compound significantly. Therefore, you should aim to hit the lifetime limit on contributions into this account as soon as possible so that the funds can be left to grow for as long as possible. The bigger the taxable gains generated in the account the more money you'll save by not paying taxes leading to a higher return and more money in your pocket at the end of the day.

When used appropriately, over the very long term, Tax-Free Investment Accounts can be powerful tools to maximise investment returns while minimizing taxes payable.

Advantages:

- Grow your investment without any taxation (no taxes on interest, dividends or capital gains) meaning more of your money is available to benefit from the power of compounding growth.
- Choose from a range of funds to suit your investment needs – Unlike retirement annuities there are no limits on how you can invest – for example you can invest in 100% offshore assets.
- You may switch between investment funds at any time and at no additional cost without incurring taxes
- Enjoy unrestricted access to your money by making withdrawals at any time and all withdrawals are tax free.
- Stop contributing at any time, without penalties.
- You can open a TFSA for minors.
- Your investment can be paid to your beneficiaries immediately. The value of the investment may be included in the estate for the calculation of estate duty and executor fees.
- You can invest monthly, start with a lump sum or transfer an existing TFSA from another provider, subject to provider minimums and the prescribed maximum amounts.
- There is no limit to the number of TFSAs you may open. However, you will need to ensure that your payments across all approved TFSAs do not exceed the annual contribution limit of R36 000 per tax year.
- Investment returns earned within the account do not form part of your annual and lifetime contribution limits.

Limitations:

- A maximum of R36 000 per tax year and R500 000 over your lifetime can be contributed - a time horizon of about 13 or 14 years to hit the lifetime limit, an important point of consideration as this is a long term investment
- Any contributions made to TFSAs over and above the R36 000 annual limit will attract tax at a rate of 40%. For example, if you invest R40 000, which exceeds the annual limit by R4 000, 40% of the R4 000 excess (i.e. R1,600) must be paid to SARS at your tax assessment date.
- Only individual investors in South Africa are eligible (no trusts, companies, etc.).
- All amounts you invest will count towards your annual and lifetime limits regardless of any withdrawals you make. Therefore, your TFSA should be the last area from which to withdraw funds.
  - For example, you have a TFSA and contributed R36,000 into the account (R464,000 remaining of your lifetime contributions). If you need access to the funds in your TFSA, they can be withdrawn but you will still only have R464,000 remaining of your lifetime contribution limit – in other words withdrawals can permanently affect the long-term growth prospects of the account.
- These maximum annual and lifetime investment limits apply across **all** of the TFSAs you may have across different financial services providers. In other words, you may only contribute R36,000, in total, across all of your TFSAs.
- A regular income cannot be paid out – interest and dividends earned are automatically reinvested.
- No protection against creditor claims.
- Any portion of your unused annual limit may not be carried forward to the new tax year.
- You may not take a loan out against your investment or use your investment as security for a loan from another financial institution.
- When setting up the account on behalf of a minor it is important to be aware that investments made in a child's name can only be withdrawn into the child's bank account. In addition, the amount you invest on behalf of your children will reduce their own lifetime contribution limit.
  - Additionally, once the child reaches the age of 18 and becomes an adult, instructions related to the account can no longer be accepted from the parents.

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