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Prudential Investment Managers
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Tax-free investing for your child's education

Every parent wants the very best for their children, which often starts with ensuring that they receive the best-possible education. Education, however, has become increasingly expensive in recent years, with Stats SA reporting a year-on-year rise in tuition fees of between 4.7-7.6% for 2020.

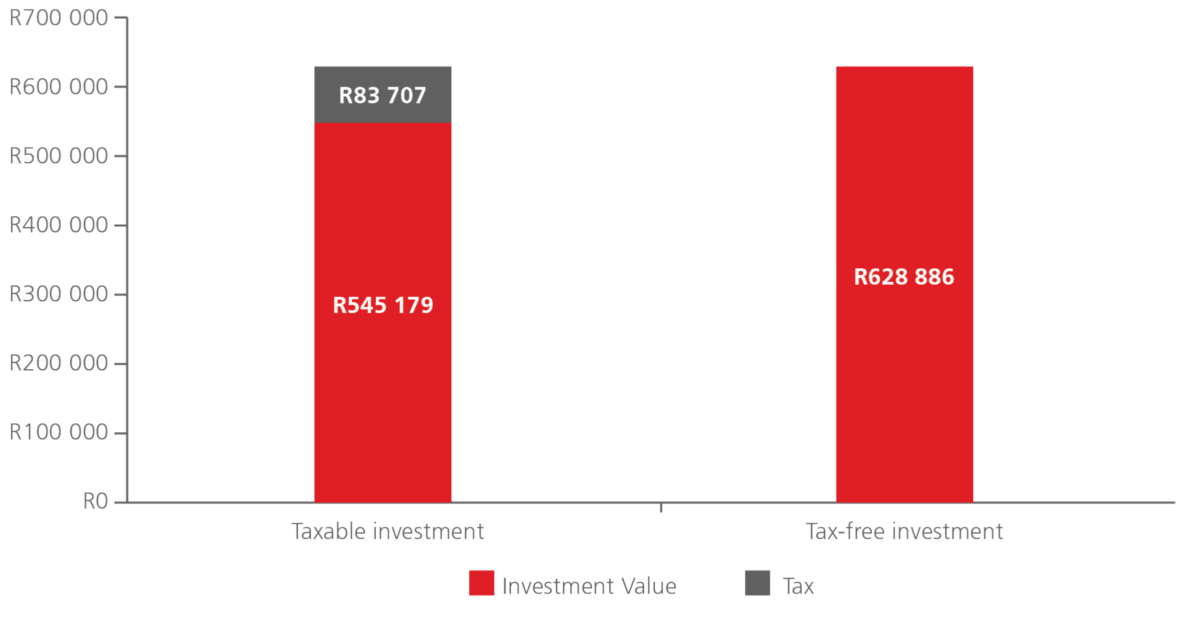
While this may sound somewhat reasonable in isolation, the compound effect of above-inflation increases over time means that you would need to save significantly more to provide your child with a good education. Fortunately, saving more is not the only option at your disposal. Investing in a tax-free, well-diversified unit trust (such as the Prudential Balanced Fund) will allow your savings to grow exponentially more over the long term compared to traditional taxable investments.

Tax-free investments: an excellent way to save for your children's education

One of the main benefits of tax-free investing is that the growth within the underlying funds is free of all local tax on interest, dividends and capital gains. This means that you will have more capital to compound over time, leaving you with a larger investment amount when you need it.

To demonstrate the benefits of this product, we compare a R3,000 monthly debit order in the tax-free Prudential Balanced Fund with a traditional taxable unit trust investment.

Benefits of tax-free investing



Source: Prudential Investment Managers

Based on the above example, a return of R628,886 in a typical taxable investment would attract R83,707 (or 13.3%)* worth of taxes, leaving you with just R545,179. **Whereas, in a tax-free investment you would receive the full benefit of R628,886**.

Another benefit of investing tax-free is that you can invest via monthly debit order, lump-sum investment, or both. You can start and stop your contributions at any time without any penalties, as well as being able to access your funds in the case of an emergency without any lengthy waiting periods.

And if you have more than one child, you can also open an account in each of your children's names and use your annual R100,000 donations tax-free allowance to contribute towards their investments. However, it's important to remain within the annual and lifetime limits (more information on this below).

By the time your kids are ready to start their education, you will hopefully have accumulated enough tax-free savings to fund a large part (if not all) of their expenses.

How much should I invest?

This largely depends on what school you plan to send your child, how long you expect your child to be at university, and how early you start your educational investment plan. It's important to remember, however, that the government allows a maximum contribution towards a tax-free investment of R36,000 a year and R500,000 over the course of the investor's lifetime (excess amounts will be taxed at a hefty 40%).

We have a range of tools on our website to help you get a good idea of what the projected cost of your child's schooling might be in the future, and how much you should contribute each month. Try our Education Calculator, Goal Calculator and Tax-Free Investment Calculator to guide you along your way.

Avoid the debt trap

When investing for your child's education, remember that your job circumstances and salary might change over time and that your child might decide to study something other than what you'd planned for.

Faced with such challenges, it may be tempting to rely on debt to fund your child's educational fees. However, try not to fall into this trap: In the same way that compound interest works in your favour when investing, the cost of interest on debt works equally as hard against you, especially if you're borrowing over an extended period. Instead, it might be more beneficial to review your current tax-free investment and to make adjustment where necessary, such as amending your contribution amount or switching into a fund that's more reflective of your future needs.

To find out more about tax-free investing, speak to your financial adviser or contact our Client Services team on 0860 105 775 or query@prudential.co.za.

*Assumptions: A gross return rate of 10.8%, an after-tax return of 9.4%, and a capital gains tax (CGT) inclusion rate of 18%. Equilibrium fund returns (net of a historical average fee adjustment) have been used for the purpose of this calculation. Tax is calculated using the 2020/2021 SARS tax year table at a marginal income tax rate of 45%. Figures assume that you have used your annual CGT exclusion and annual interest exemption.

https://www.prudential.co.za/insights/articlesreleases/tax-free-investing-for-your-childs-education/