M&G Investments
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The ABCs of tax-free investments

With all the social, economic, and political challenges facing South Africa, investors need all the good news they can get. Tax-free investments qualify as good news for local investors, as they are a great way to save - whether you're putting money aside for a rainy day, saving towards something specific like your child's education, or as a supplement to your existing retirement savings.

However, there may be some of us who aren't yet embracing this great initiative to save towards the future. So, we've outlined the ABCs of tax-free investing below to clear up any confusion and to encourage you to start investing.

A is for Ask
If you aren't exactly sure how tax-free investments work, the other good news is that they aren't that complicated. Below are some frequently asked questions to explain what tax-free investments are about.

What are tax-free investments?
Tax-free investments were launched in 2015 as part of the government's initiative to encourage South Africans to save more. Unlike normal unit trusts, your investment returns are exempt from all local taxes, including income tax, dividends tax and capital gains tax.

Who can invest in tax-free investments?
Tax-free investments are only available to individuals (including minors) who are South African residents.

How much can I invest?
The maximum amount that you can invest for any tax year is R36,000, while the maximum amount you can currently invest over the course of your lifetime is R500,000. Exceeding these limits has hefty tax consequences. It's also important to remember that the unused portion of your annual limit will fall away and not get carried over to the next tax year – so invest the maximum R36,000 if at all possible. Your investment growth (including income distributions) does not count towards your maximum limits.

B is for behaviour
Tax-free investments are flexible, in that you can pause contributions if you are doing so via debit orders at any time. While they can be seen as a supplementary investment for your retirement savings, they are not regarded as deductible for income tax purposes.

Even though you can access your funds as you would a discretionary unit trust investment, it's best not to regularly withdraw from your tax-free investment. The main objective of these products is to grow money over time, tax free. Regular withdrawals defeat this purpose and reduce your overall amount contributed, since you can't replace the money you withdraw.

C is for Contributions
The amount you can contribute to a tax-free investment is intentionally specific because of the tax benefits you'll enjoy. To ensure you understand how it works to contribute over time, here is an example.

As R500,000 is the fixed lifetime limit on contributions, it makes sense that your contributions made over the course of your lifetime will be gradually deducted from this total. Any withdrawals you make have no impact on this calculation.

For example: Jabu starts a new tax-free investment with a lump sum contribution of R36,000 for the tax year. His remaining maximum limits are calculated as follows:

- Annual limit: R36,000 - R36,000 = R0 remaining for year
- Lifetime limit: R500,000 - R36,000 = R464,000 remaining

Jabu decides to withdraw R10,000 later in the same tax year. His remaining maximum contribution limits are unchanged at R0 (annual limit) and R464,000 (lifetime limit). The reason for this is that withdrawals do not factor into the maximum limits (as shown in the formulas above). So, when Jabu withdraws R10,000, he is never allowed to "replace" that R10,000 above the R36,000 contribution limit.

It's crucial not to overcontribute (i.e. don't replace what you drew out to try and reach R36 000 again for the year). SARS will tax any of your excess contributions (i.e. the amount above the maximum limits) at a rate of 40%.

You might also wonder if you can invest on behalf of your children. This is allowed, but important to keep the following in mind:

- Contributions to their investments are counted towards their annual and lifetime limits.
- Contributions above the maximum limits are subject to 40% tax.
- Withdrawals from their investments can only be made to a bank account held in their name.
- Contributions made on their behalf are regarded as donations, and may be liable for donations tax. Currently, SARS exempts the first R100,000 donated by an individual from donations tax.

Keen to invest in a tax-free investment with M&G Investments?
Simply complete the application process online or contact our client services team on 0860 105 775 or info@mandg.co.za.

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