M&G Insights

M&G Investments
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Thinking about going tax-free? Don’t wait.

The benefits of long-term investing can be hard to appreciate until you see them accumulate for yourself. One of the best ways to enhance your wealth is to make the most of a tax-free investment. As is so often true with investing, the earlier you start, the better.

Tax-free investments were launched almost a decade ago (March 2015) to provide a solution that incentivised South Africans to save and invest, within specific limits. The annual contribution limit is R36 000, while the lifetime contribution limit is R500 000. All local investment returns are tax-free.

What are the benefits of tax-free investments?

- All growth in the underlying investment is fully exempt from any SA tax on interest, rental income, dividends or capital gains;
- Investors can withdraw their money at any time (but it’s better to think of this investment as long-term);
- Contributions are flexible – either via a lump sum or debit order;
- Tax-free investments are not subject to retirement investment limits as set out in Regulation 28 of the Pension Funds Act; and
- Parents can open separate accounts for their children.

How do tax-free investments fit alongside retirement savings?
A consideration when deciding whether to invest or not is that contributions to tax-free savings products can only be made from after-income-tax money. If you are investing tax-free for retirement, this leaves you less to invest and to grow compared to retirement annuities (RAs), where your contributions are exempt from income tax up to a limit of 27.5% per year, plus growth is exempt from all taxes. This means that, from a maximum return perspective, it would probably be better to exhaust your RA contribution limit every year before investing in a tax-free savings product.

However, if you are investing for a shorter time, or require more accessibility, RAs currently do not allow you to withdraw your accumulated savings until age 55, whereas tax-free savings products are accessible at any time. RAs are also subject to Regulation 28 investment restrictions on the amounts of each asset classes your fund invests in, while tax-free investments are not, as mentioned above. We suggest that you consult a financial adviser to ensure you make the most efficient decisions for your unique personal circumstances.

Why do tax-free investments work best long-term?
To maximise the advantages of tax-free investments, you should consider investing in longer-term assets like equities and listed property, or diversified funds like balanced unit trusts with relatively high exposure to these assets. This is because in theory they are likely to deliver better returns than cash and bonds over time, so the effect of compounding returns will be more powerful than other options.

Of course, these growth assets do come with more risk, so it's best to stay invested for five to 10 years. This makes tax-free investments more suitable for longer-term goals like a home for your family and your retirement.
If you withdraw a sum from your tax-free investment, it doesn't change your lifetime or annual limits just because you've made a withdrawal (in other words, you can't replace contributions). We would encourage investors to avoid withdrawals, if at all possible, because they reduce the compounding growth effect over time.

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The current tax year ends on 28 February, so it's important to utilise your maximum annual allowance of R36 000 as this does not roll over to the next year. Be careful not to overcontribute, or you'll be taxed 40% by SARS. M&G Investments offers a range of tax-free unit trusts to suit a variety of risk and return requirements. For more information, contact your financial adviser or our Client Services team on 0860 105 775 or at info@mandg.co.za.

https://www.mandg.co.za/insights/articlesreleases/thinking-about-going-tax-free-don-t-wait/