INVESTMENT REPORT

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THE POWER
OF INDEPENDENT ADVICE

BE SMART WITH TAX AS END OF TAX YEAR LOOMS

WHERE TO INVEST SAVINGS FOR OPTIMAL GROWTH AND TAX EFFICIENCY REMAINS TOP PRIORITY FOR MOST INVESTORS

By Danine van Zyl - Financial Advisor, Brenthurst Wealth Fourways

Not sure if you should invest in a retirement annuity (RA), tax-free savings account (TFSA) or discretionary investment for retirement?

Where to invest savings for optimal growth and tax efficiency remains top priority for most investors when they seek professional financial planning advice. The majority select a RA as the most logical option for their needs. However, this might not always be their best or only option.

Saving for retirement through retirement annuities and preservation funds has always been widely recommended due to the tax benefits available. **Investors are entitled to a tax deduction on their RA contributions of up to 27.5% of their taxable income or remuneration, limited to a maximum of R350 000.**

Furthermore, growth on the investment is free of any capital gains or dividend withholding tax implications – the objective being to encourage investors to save towards their retirement to prevent them from ultimately becoming dependent on government support. Controversial legislation designed to protect investors has, however, resulted in poor performance over several years and, as an unintended consequence, has made the assets held by investors in these products vulnerable to governmental decision-making.

Regulation 28 of the Pension Funds Act prescribes and limits pension monies to 75% equity exposure, listed property to 25% and offshore exposure to 30%. This composition is generally reflected in balanced unit trust funds and has been a popular choice for pension monies where the asset manager ensures compliance with Regulation 28. Most of these funds hold around 40% in South African equities. **In the long term the returns from the JSE have, however, been extremely poor by global comparison.**

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"Investors who are invested in a retirement product may retire from their investment from the age of 55 and transfer the proceeds to a living annuity (LA).

Living annuities allow investors to obtain up to 100% offshore exposure and generate similar returns as in a discretionary investment."

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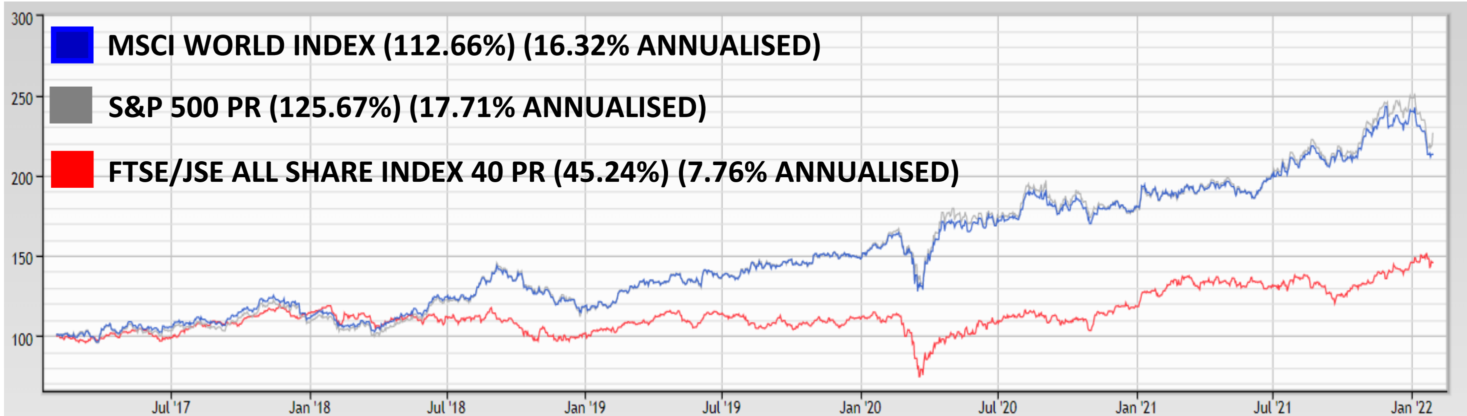
The JSE All Share Index delivered 7.76% over the past five years, which explains the poor average performance of Regulation 28 compliant balanced funds. In sharp contrast, the S&P 500 and the MSCI World Index delivered 17.71% and 16.32% respectively.



The downside of investing in a product such as a discretionary investment, which is not subject to Regulation 28 of the Pension Funds Act, is the liability towards interest, dividend and capital gains tax earned on the investment.

COMPARISON FOR A YOUNGER INVESTOR AT AGE 30 WANTING TO RETIRE AT THE AGE OF 55

Investment amount	**R137 500**
Retirement Annuity growth rate	7.76%
Discretionary investment growth rate average	17.02% (17.71% + 16.32%/2 as paragraph above)
Salary	R500 000 (Marginal tax rate of 36%)
Inflation	5%
Term	25 years

Capital at the end of the term in nominal terms

	Retirement Annuity	**Discretionary Investment**
Initial amount invested	**R137 500 (27.50%)**	**R137 500**
Amount at 50	R890 722	R6 995 279
Growth	R753 222	R6 857 779
Tax saving	R45 370	
CGT payable		R987 520 (40% x 36%)
Capital at the age of 50 with tax break	**R936 092**	
Capital at 50 after CGT		R6 007 759

The difference between investing in a discretionary investment and investing in a RA, which is subject to Regulation 28 of the Pension Funds Act, is **R5 071 667**.

COMPARISON OF AN OLDER INVESTOR AT AGE 54 WANTING TO RETIRE AT THE AGE OF 55

Investment amount	**R137 500 (27.50% x R500 000)**
Retirement Annuity growth rate	7.76%
Discretionary investment growth rate	17.02% (11.33% + 14.25%/2)
Salary	R500 000 (Marginal tax rate of 36%)
Inflation	5%
Term	1 Year

Capital at the end of the term in nominal terms		
	Retirement Annuity	**Discretionary Investment**
Initial amount invested	R137 500	R137 500
Amount at 55	R148 170	R160 903
Growth	R10 670	R23 403
Tax saving	R45 370	
CGT payable		R3 370 (40% X36%)
Capital at 55 with tax break	**R193 540**	
Capital at 55 after CGT	N/A	R157 533

The difference between investing in a RA at an older age and investing in a discretionary investment is **R36 007 – making a RA the more attractive alternative**.

Investors who are invested in a retirement product may retire from their investment from the age of 55 and transfer the proceeds to a LIVING ANNUITY (LA). As living annuities are governed by the Income Tax Act, the restrictive provisions of Regulation 28, as contained in the Pension Funds Act, are not applicable to these investment products. This enables investors to obtain up to 100% offshore exposure which generates similar levels of returns as can be obtained in a discretionary investment.

CONCLUSION:

Younger investors, who invest in a discretionary investment, should receive significantly larger returns once they retire compared to similar young investors who invest in a RA with the purpose of receiving tax relief.

If you are an older investor who can retire from a RA within a year, a RA will be more beneficial, but only if the capital is transferred to a living annuity thereafter, in order to obtain similar levels of growth generated by a discretionary investment.

However, whether an investor is young or old, they should make use of a TFSA and contribute the maximum allowed annually, which is currently R36 000 for the 2022 tax year.

The TFSA will allow an investor to invest 100% offshore which will generate similar returns to that of a discretionary investment, but without being required to pay any tax on the growth.

If you want to make contributions for the current tax year, do not delay. To ensure that a company can report your contributions to a RA or TFSA during the 2022 tax year to SARS, the contribution amount must reflect in the company's bank account by the 28th of February.

It should be noted that each investor has different needs, objectives and risk profiles, and as such the same advice will not apply to everyone. It is advisable to always consult an accredited, qualified financial planner to devise a plan best suited to your personal circumstances and financial goals.

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