Build Wealth by Paying Less Tax

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THE ISSUE

Statistics show that only 6% of South Africans make adequate provision for retirement. Government consequently encourages individuals to save for retirement by offering tax incentives to those who invest in registered retirement funds like retirement annuities.

WHY THE END OF THE TAX YEAR IS IMPORTANT TO YOU

February is an important month as it is the last opportunity in the tax year to make use of these incentives. The current tax year ends on 28 February 2022.

HOW YOU CAN BENEFIT

As individual you may contribute up to 27.5% of your non-retirement funding income (after deducting exemptions and deductions allowable against such income) towards retirement funds and enjoy tax deductibility. This is the easiest way to reduce your taxable income, and ultimately pay less tax. By implication, SARS could pay up to 45% of your contributions to your retirement funds. Ensure that you understand the value of this.

TAX ON THE GROWTH OF YOUR INVESTMENT

The underlying investments in a retirement annuity are not subject to capital gains tax (CGT) or income tax on interest and dividends earned. This is an advantage over other savings products like pure unit trusts, which are subject to both income tax and CGT, either in your hands or in the hands of the fund manager.

MORE TAX SAVINGS AND PROTECTION AGAINST CREDITORS

On death, a retirement annuity is free from Donations Tax (20%), Estate Duty (20%), Capital Gains Tax (depends on marginal tax rate) and Executors Fees (3.99%). In case of insolvency, the investment is protected from creditors. Beneficiaries can also be nominated to inherit the proceeds without having to pass through the individual's estate.

INVESTMENT VEHICLE CHOICE

Insurance companies market underwritten RAs. These products tend to be more expensive and inflexible. New generation RAs offered by investment houses (e.g. Allan Gray) tend to have lower fees, no penalties for surrender/discontinuation and greater flexibility.

DIVERSIFY BETWEEN FUND MANAGERS

You can choose which underlying unit trusts to invest in that best suit your needs, across different sectors from different providers (provided your account complies with the asset allocation limits outlined in the retirement fund regulations).

IS THERE A CATCH?

Retirement money is invested for retirement. Unless you pass away or become permanently disabled, it is only accessible on age 55. The money is thus not only protected from creditors, but also from yourself. It prevents you from stealing from your future self.

WHEN IS TAX PAID?

On retirement, a member is entitled to ⅓ of his retirement funds in a lump sum. This is currently taxed according to the following table:

R 0 – R 500,000	:	0% of taxable lump sum
R 500,001 – R 700,000	:	18% of taxable lump sum above R 500 000
R 700 001 – R 1 050 000	:	R36 000 + 27% of taxable lump sum above R 700 000
R 1 050 001 and above	:	R130 500 + 36% of taxable lump sum above R 1 050 000

The rest of the ⅔ has to be reinvested in an annuity from which you will draw a monthly or annual income as retiree. This income is taxed like normal income tax. Two things need to be noted here:

1. The receiver (SARS) will always take his cut. Investing in an RA as opposed to an after tax savings vehicle merely allows the Receiver to take less. The calculations show this.
2. Individuals 65 years and older pay less tax by enjoying a larger annual rebate from SARS. You will consequently postpone paying tax on your retirement monies and do so when you will probably draw less income to be taxed on.

THE NEXT STEP

It is advisable to discuss any decisions involving your finances with your financial planner. Make sure that you benefit from this and that your contributions are submitted prior to **28 February 2022**.