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Making the most of personal tax incentives

After spending decades nurturing their careers, most people hope to enjoy the fruits of their labour in the form of a sustainable income in retirement. Making efficient use of existing tax incentives is one way to increase the odds of achieving this goal. Carrie Norden shares some ideas to help you maximise the amount of "tax-free" money available to you when you reach retirement age – a timely message as we approach the end of February, which is the end of the 2019/2020 tax year.

Tax efficiency is a key aspect of a healthy financial plan, yet many investors fail to take tax into account when looking at how they can maximise their potential investment returns. By considering the tax implications of our financial decisions and incorporating existing product-related incentives into our long-term investment strategies, we can improve our chances of retiring comfortably and increase the amount of financial flexibility we have before and at the point of retirement.

Saving for retirement

The government has provided incentives for investors to invest in retirement annuities, pension funds and provident funds by providing generous annual tax deductions for these contributions, whether they are made by the investor directly or by their employer on their behalf. This annual tax deduction is limited to 27.5% of the greater of your remuneration or taxable income, capped at R350 000 per tax year. The tax benefit for contributions in excess of these annual limits may carry over to future tax years, with the ability to reduce your tax liability in those years, whether as an annual tax deduction, a reduction in the tax liability on your living annuity income, or as a reduction in the lump sum tax you pay on cash amounts withdrawn from a retirement fund during your lifetime (before or at retirement) and even on your death.

While pension and provident funds are made available to you through your employer, a retirement annuity is a product that you can hold in your personal capacity and is a great way to save for your retirement and/or to supplement your existing employer-based retirement savings.

Current legislation allows you to access the funds in your retirement annuity from the age of 55 (or beforehand, in certain circumstances, such as emigration). However, you can remain invested and continue contributing for as long as you like. When you retire (from the age of 55), you may choose to withdraw up to one-third of the retirement annuity fund's value as a cash lump sum, unless the fund value is not greater than R247 500, in which case you may withdraw the full amount in cash. The balance must be used to purchase an income-providing product, such as a living or guaranteed life annuity. The cash amount is taxed according to the retirement lump sum tax tables, and the first R500 000 of your cash lump sum is tax-free. However, it is important to remember that this is a once per lifetime benefit and takes previous taxable lump sums into account (including severance benefits). If you are unsure what the tax liability may be, it is recommended that you contact SARS to confirm or ask your fund to perform a tax directive simulation, before you give the go-ahead to take your portion in cash.

The benefits of tax-free investing

If you are already maximising your annual retirement fund tax deductions, or you prefer not to have all your money tied up until the age of 55, you may want to consider supplementing your long-term savings with a tax-free investment. This product may help you walk away with additional tax-free money when you retire, while providing greater flexibility than a retirement fund investment. Tax-free investments are another tax-incentivised savings product the government uses to encourage long-term investment.

Although your contributions aren't tax-deductible, the real long-term benefit of this product is that you don't pay tax on any of the interest, dividends or capital gains generated by your investment. This gives investors the opportunity to gain greater compound growth over longer periods of time.

Current legislation allows taxpayers to invest a maximum of R33 000 per tax year and R500 000 per lifetime in tax-free investments. These contribution limits apply per investor, regardless of the number of tax-free products owned. It is important to remain mindful of these limits as SARS levies a 40% penalty on any overcontributions. It is also worth noting that any money you withdraw from a tax-free investment cannot be re-contributed. By way of example, if you were to invest R33 000 in a tax-free investment in April and decide to withdraw R20 000 of it in October of the same year, you would not be able to replace the R20 000 withdrawn by re-contributing that amount.

Set yourself up for maximum success

Depending on your needs, objectives and available disposable income, you could consider investing in both products to increase the amount of tax-free cash at your disposal at retirement.

If you contribute the maximum amount to a tax-free investment over your lifetime (which would take a minimum of 15 years) and keep that money in the investment until you reach retirement age, you would have access to your initial contribution of R500 000 and all the compounded growth generated by the interest, dividends and capital growth over your investment period. Add to this the additional R500 000 cash lump sum available tax-free from your retirement fund on retirement, (less any previous taxable lump sums you received along the way), and you have a healthy cash amount available with no tax liability.

There are a few things you can do to ensure that you maximise the benefits of the products in order to ensure the best possible investment outcomes:

1. **Stay invested for as long as possible**
   One of the most important factors that influence long-term investment success is time. This is because investment returns compound over time, i.e. you earn additional growth on your interest, capital growth and dividends, drastically improving the rate at which your money grows.

   With a few exceptions, money invested in a retirement annuity can't be accessed before you reach the legal retirement age of 55. Depending on when you start investing, this should give your money meaningful time to grow.

   Although you can access your tax-free investment, it is very worthwhile exercising discipline as the real benefit of the product is experienced over time.

2. **Always preserve your retirement savings**
   One of the major reasons many retirees fail to accumulate enough wealth to sustain their retirement is that they access their retirement savings before reaching retirement age.

   It may be tempting to cash out a portion of your pension or provident fund when you change jobs or are retrenched, but this will ultimately reduce the amount of money you have access to when you retire. The first R25 000 of a pre-retirement withdrawal lump sum (taking previous taxable lump sums into account) is taxed at 0%, according to the withdrawal lump sum tax tables. This is a once-off benefit over your lifetime.

3. **Top up your savings before the end of each tax year**
   Your annual retirement annuity and tax-free investment contribution allowances do not roll over if you don't contribute enough to fully benefit from them. If you want to maximise your contributions and the tax benefits you are entitled to, you must ensure that you do this before the end of each tax year. You need to do so well in advance of the end of February deadlines.

4. **Get professional advice**
   A well-considered financial plan should account for your unique circumstances and make use of the various incentives that exist to maximise your long-term returns. An independent financial adviser can play an indispensable role in helping you construct a solid financial plan and stay the course as you set out to achieve your long-term financial goals.

Commentary contributed by Carrie Norden, tax manager, Allan Gray

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