

Why bank tax-free when you can invest tax-free?

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If you have R250 per month or more to put away every month for your future, you may be interested in taking advantage of one of the ultimate tax hacks available at present, says Coronation Fund Managers.

To encourage a culture of savings, National Treasury passed legislation three years ago to allow South Africans to save tax free through either a tax-free savings (TFS) account or a tax-free investment (TFI) product. By offering a product in which you don't pay any tax on the income, dividends or capital gains generated within the product, or at the time of withdrawing your money, they believed that individuals would be encouraged to increase their household savings.

However, according to Coronation, the uptake of these products since their introduction has been very low. Today only about half a million individuals save tax free, mainly through TFS accounts with the banks.

While Coronation commends those who have already made the smart move to save whatever they can, they believe it is important to understand the difference between saving tax free and investing tax free. According to Coronation, it boils down to how long you plan to save.

Investing (vs saving) is smarter over the long term

If you are planning to save for the long term (i.e. more than five years), you really want your money to work as hard as it can and have the best potential to grow, explains Coronation.

When you save with a bank, your money earns a predictable level of interest. When you invest with an investment manager in a product such as a unit trust, your money is invested in financial assets such as shares, bonds and property. Over the long term, these financial assets have greater potential to give you better returns than you would get from just saving your money with a bank.

Remember, you need to beat inflation

One of the key obstacles to overcome when investing is inflation. In order to grow your purchasing power over time (which is just financial speak for your ability to buy what you want), it's important to invest in assets that grow more than inflation – otherwise you simply end up in the same or even a worse position.

The problem with saving with a bank is that, while you receive a predictable rate of interest, you hardly ever do better than inflation. Whereas, growth assets (such as shares and listed property) can protect your money over time from the erosion of inflation.

Here's an example: had you invested R1 in the money market with the bank 90 years ago, you would essentially only be able to purchase R1.15 worth of goods today. But, had you invested it in shares, you would be able to purchase R538 worth of goods today – truly a remarkable difference.

So, is investing tax free (vs saving tax free) a bit of a no-brainer?

The key with investing is to really think long term. By investing over multiple decades as you head towards retirement, leaving your money invested allows it to withstand any ups or downs that can happen in the short term when investing in financial assets. Over the long term, these bumps typically smooth out and the overall trend is generally for your money to grow more over time than it would if it was just earning interest in a bank.

Remember, there are some limits to investing tax free

If you decide to invest via a monthly debit order, you can start from as little as R250 with Coronation up until end March, or up to a maximum of R2 750. If you decide to invest annually, you can contribute a maximum of R33 000 per tax year, and up to a maximum of R500 000 over your lifetime.

Investors also have unrestricted access to their money within a TFS account or TFI product. However, just be mindful that all amounts invested will count towards your annual and lifetime limits regardless of any withdrawals you make. In other words, you cannot 'replace' the money you withdraw with a new investment.

So, is it a hassle to move from a TFS to a TFI?

It's easier than you might think to switch from a tax-free savings account to a tax-free investment product, and there are no costs of switching either.

Your best course of action would be to speak to your financial adviser (if you have one) or give Coronation a call to assist.

Investing tax-free with Coronation

Coronation's TFI product offers access to a range of domestic flagship funds. You can also access international assets through a number of their rand-denominated international flagship funds.

To find a fund that is suitable to your needs, visit www.coronation.com/tax-free.

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