



HOW DOES A TAX FREE SAVINGS ACCOUNT WORK

What is a tax free savings account

A tax free savings account is best explained using the example of a gift at Christmas time... The gift consists of two parts – the wrapping paper and then the actual content of the wrapping paper. Whilst the wrapping paper gives the gift a nice “look and feel”, the real important “thing” is contained inside.

A tax free savings account can be compared with the “wrapping paper” – it gives the investment a specific look and feel but at the end of the day, it is the “gift” that makes the investment perform and not the “wrapping paper”. The performance of the investment is driven by the assets contained within the tax free savings account wrapping paper. These assets usually consist of various unit trusts (explained later).

Having said the above, the “look and feel” that the investment gets from the tax free savings account “wrapping paper” is important because it basically determines the “rules” of the investment. In the case of a tax free savings account these rules are driven by certain very specific SARS requirements, which if met result in favourable tax benefits accruing to the investment. These rules and benefits are explained below.

How does it work / how is it structured

As mentioned a tax free savings account consists of a combination of unit trusts (as chosen by you – with our guidance). These unit trusts are the “heart” of the investment – the gains / losses in your investment are driven by the performance of these unit trusts.

The practical administration of the investment is pretty “relaxed” and it can almost be compared to a bank account – you can invest cash (up to certain limits), withdraw cash, set up debit orders, change debit orders, cancel debit orders, reinstate debit orders, switch unit trusts etc. all without penalties and as and when you like as long as you “stick to the SARS rules” (outlined below). A tax free savings account is therefore very liquid (i.e. the cash is always accessible) and easy to maintain.

What are the SARS rules governing a Tax Free Savings Account

For your investment to qualify as a tax free savings account it needs to abide by the following rules:

- You may not invest more than R36,000 p.a. in a tax free savings account (across all service providers). Any investments in excess of this limit will be taxed heavily (i.e. at 40%);
- You may not invest more than R500,000 during your lifetime in a tax free savings account;
- Growth and the reinvestment of interest and dividends in the Tax Free Savings Account do not count towards the above contribution limits;
- The above limits are capped which means that withdrawals cannot be replenished i.e. if you contribute the maximum R36,000 in a year but then withdraw R10,000 during that year, you cannot contribute a further R10,000 in that same year hoping to replenish the fund value back to the R36,000 maximum. The R36,000 limit is cumulative.



Taxation effects of a tax free savings account

Your investment will grow by earning a combination of dividends, interest, rental incomes and capital gains. None of these returns are taxable in this investment. This is essentially the benefit of having the Tax Free Savings Account “wrapping paper” around your “gift” i.e. this is the benefit of this specific investment product.

What happens to my investment should I pass away

At death the tax free savings account will be liquidated and paid into your estate from where the cash will be distributed in terms of your last will and testament. It therefore forms part of your estate for estate duty purposes unless a beneficiary can be added. This is dependent on the service provider and how the product is set up.