A TAX-FREE SAVINGS ACCOUNT ISN'T WHAT YOU THINK. IT'S BETTER

By Mariska Redelinghuys – Sygnia Retail Legal Advisor

Got a nice rebate from the taxman? Now's the time to be smart and open a tax-free savings account. You'll thank yourself later.

It's tax rebate season. 'Tis the time when lucky women and men across the land are deciding what to do with their gifts from SARS. Investing it into a tax-free savings account (TFSA) is always a smart option. But there's a lot of misinformation out there, so not everyone knows what tax-free savings accounts are good for and when to use a tax-free savings account. Sygnia's retail legal advisor Mariska Redelinghuys tackles some common myths.

MYTH 1: A TAX-FREE SAVINGS ACCOUNT IS A SINGLE, STANDARDISED PRODUCT
Totally false. A tax-free savings account can be a money market or fixed term bank account, a unit trust investment, a JSE-listed exchange traded fund and many more. Sygnia offers a range of our low-fee index-tracking funds as a TFSA. Other providers will offer a different mix.

However, National Treasury did place some limitations on the composition of a TFSA: it must be transparent; the fees must be reasonable; no performance fees can be charged; and there is a limit on what "penalty" fee the provider may charge for early withdrawal.

Now, what constitutes as a "reasonable" fee depends on who the provider is – it can be as much as 1% to 2%. For Sygnia, reasonable is as low as possible, so our fees for a TFSA start from 0.4%. These are management fees and that's all you will pay; we don't charge admin fees, initial fees or penalty fees if you decide to stop contributions or withdraw early.

MYTH 2: RETURNS ON TAX-FREE SAVINGS ACCOUNTS ARE CAPPED
There is absolutely no limit to how much your investment can grow. So if you choose an incredibly well performing fund, you could double, triple or even quadruple your savings with no ramifications. That's how a tax-free savings account can really work for you.

MYTH 3: THERE IS A MONTHLY INSTALLMENT COMMITMENT
No, you can even invest in a once-a-year lump sum if you prefer. So every time tax rebate time comes around, you could reinvest that money into your TFSA. However, some providers may put a minimum limit on your investment for administrative purposes.

MYTH 4: YOUR TAX-FREE SAVINGS ACCOUNT CAN ONLY BE ONE INVESTMENT

You can actually choose to make up a TFSA with a few different savings and investment products, as long as your total contributions do not exceed the annual and lifetime contribution limits. The most you can contribute to a tax-free savings account is R30 000 per tax year, while the maximum lifetime contribution is R500 000.

For example, you could choose to invest R14 000 a year into one of Sygnia's low fee balanced Skeleton Funds and invest the balance into something a bit higher risk, like the new Sygnia 4th Industrial Revolution Global Equity Fund, which effectively allows you to become a venture capitalist in new tech with a R10 000 lump sum and a R500 per month investment. Using that example, you can create a balanced portfolio for your TFSA and not exceed the R30 000 per year contribution cap.

MYTH 5: YOU CAN ONLY OPEN A TAX-FREE SAVINGS ACCOUNT AT ONE PLACE

Technically, you may open a TFSA with any number of providers as long as your total contribution to all does not exceed the contribution caps. But I wouldn't advise it because it can be tricky to keep track of how much you're paying across providers and that creates the risk of exceeding the cap, in which case you will be taxed heavily – 40% on every cent over the limit.

What you may also do is open a tax-free savings account for your child, but bear in mind that each person is only allowed a lifetime TFSA contribution of R500 000, so whatever part of that amount you invest into the account on their behalf will affect their own future tax-free savings contributions.

MYTH 6: A TAX-FREE SAVINGS ACCOUNT IS ONLY FOR PEOPLE WHO CAN'T AFFORD A RETIREMENT ANNUITY

It's definitely not limited to any income group – anyone can open a TFSA.

Tax-free savings accounts in South Africa were created by National Treasury not as retirement products but to encourage general household saving. Therefore a TFSA is suitable for any person who has some discretionary money – like a tax rebate – which they want to put into a savings or investment vehicle that does not incur any tax (the only tax you may pay on a TFSA is if you pass away, in which case, depending on the product, it could become part of your estate and is subject to estate duties).

No tax is the single biggest reason why you should use a tax-free savings account: there's no tax on the growth of the investment (including dividends) or capital withdrawal. The joy of not paying any tax on investment growth is that whatever you do not "lose" to tax accelerates your investment's growth because of compounded interest.

MYTH 7: A TAX-FREE SAVINGS ACCOUNT IS AN ALTERNATIVE TO A RETIREMENT ANNUITY
Tax-free savings accounts in South Africa were not created especially to be a retirement product, although you may use it for retirement savings.

The lifetime contribution limit of R500 000 is not a big amount to retire with, so I would certainly not suggest only having a TFSA for retirement. Rather, it should be one part of your overall retirement investment. Therefore this constant debate around tax-free savings accounts versus retirement annuities is actually misplaced.

MYTH 8: YOU CAN ONLY WITHDRAW FROM YOUR TAX-FREE SAVINGS ACCOUNT AT RETIREMENT
You can take it out at any time, and in fact the regulations say the money must be made available to you within seven days. The only exception being if it's a fixed deposit account you've chosen, then the provider has a bit longer to pay out.

What's important to remember here is that if you do withdraw you cannot roll over that amount as a contribution for the following year. For example, if you withdraw R10 000 this year, you cannot then invest R40 000 next year – the maximum annual contribution limit still applies.