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Tax-free savings FAQs

A tax-free savings account (TFSA) is a convenient and flexible way to accumulate savings over time in a tax-efficient manner. Here are some of the common FAQs.

Q Give me the basics. What is a TFSA?

Tax-free savings accounts (TFSAs) were introduced in 2015 to encourage South African residents to save more. Through a TFSA, the growth and income received on the investment is tax free, which means you are not liable for any capital gains tax or income tax on the dividends and interest received on your investment.

Q How much can I invest in a TFSA?

There are limits to how much you can contribute. Currently, the maximum amount you can contribute to a TFSA is R36 000 per year (or R3 000 per month via debit order) and the maximum lifetime contribution is R500 000. Don't be daunted by this amount, however. You can start your TFSA investment with Ninety One Investment Platform from as little as R500 a month.

Q Can I withdraw from a TFSA?

You can withdraw money from your TFSA at any time without penalties. However, withdrawals do not create additional contribution room. This means that if you've already used your full annual contribution limit for the tax year, you won't be able to top up again until the next tax year – even if you haven't reached your lifetime contribution limit. Once you've reached this lifetime limit, you won't be able to make any more contributions. By dipping into your TFSA over the short term, you are not only missing out on the tax benefit that accumulates over time, but you're also losing out on the potential long-term returns.

Q What investment horizon should I have for my TFSA? Can I use it as a short-term emergency cash pool?

TFSA's are best suited to long-term investing – whether to supplement your own retirement savings or to help fund your children's future needs as adults, such as tertiary education or a deposit on a first property. Over time, the value of the tax incentive becomes more meaningful.

Since all growth and income earned in a TFSA is tax free, the benefit builds up as your investment compounds without any tax drag. This tax advantage typically becomes more significant over longer investment periods as capital growth accumulates.

It's also important to remember that there is a maximum lifetime contribution limit of R500 000. Withdrawals do not create additional contribution room. If you've already used your full annual contribution limit, you won't be able to contribute again until the next tax year – and once you've reached the lifetime limit, you won't be able to make any more contributions.

Dipping into your TFSA for short-term needs can therefore reduce the long-term value of the tax-free growth you can achieve. You may not reap the full benefits of your contributions if you make short-term withdrawals.

Q Almost every financial services company offers a TFSA in some form or other. It can be confusing to pick one. Where do I start?

Keep it simple. There are a multitude of service providers and options to choose from, which can feel overwhelming. There are several benefits to using an investment platform. In addition to the fact that investment platforms offer an extensive choice of local and international funds covering all risk profiles, asset classes and sectors, investors also have the flexibility to switch between them. Furthermore, investors can easily see a consolidated view of their entire portfolio, which might include a retirement annuity and discretionary investments in addition to a TFSA.

Q How do I decide between the multitude of underlying funds offered by a platform?

Given our view that TFSA's are best suited to long-term investing, we believe the portfolio's asset allocation should reflect a long-term view and have a higher allocation to growth assets (such as equities, both locally and offshore), rather than a large allocation to cash, which typically delivers much lower returns over time.

It's simpler to illustrate with an example: If you're diligent, and set up a TFSA once your child is born, you'd be able to contribute R3 000 per month for just short of 14 years before you reach the current maximum allowed contribution. If you invest in a growth portfolio that generates investment returns of 10% per year after all costs, the value of your investment at the end of that 14 years would be just over R1.2 million. Taking inflation into account, the equivalent value in today's money terms would be around R500 000.

If you had instead invested these TFSA assets in a money market fund (or cash deposit), the portfolio would likely be worth only R330 000 or less in today's money terms.

It seems that a good starting point for most TFSA investors is to have a look at South African unit trust funds from the "ASISA Domestic Multi-Asset: High Equity" or similar category. These funds have historically produced very attractive long-term risk-return trade-offs, and work even better when tax does not affect the structure of the investment decision.

One can comfortably move even higher up the risk curve, especially for longer investment horizons. The most commonly selected investment option on our investment platform has been the [Ninety One Global Franchise Feeder Fund](#).



Are TFSAs the only tax-efficient savings vehicles?

TFSAs are a fantastic additional incentive to encourage investors to save more, specifically for those with a long-term horizon, but the first savings priority for any investor should still be their contribution to a registered retirement fund (either through their employer or via a retirement annuity).

Secondly, investors sometimes forget that they have an annual tax-free interest exemption. Where the interest earned on cash investments remains within this exemption, no income tax is payable on that interest. For this reason, it can make sense to make use of the exemption to set up an emergency cash pool rather than relying on a TFSA for this purpose.

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