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Legal Update: Tax Free Investments

Summary

The Taxation Laws Amendment Act No.43 of 2014 (“the Act”) was published in Government Gazette No.38405 on 20 January 2015. In line with National Treasury’s (“Treasury’s”) previous submissions, the Act introduces tax free investments (referred to as tax free savings and investment accounts in the Regulations) with effect from 1 March 2015. A summary of Treasury’s proposals on tax free investments was discussed in Legal Update 11 of 2014.

The implementation of tax free investments are part of Treasury’s non-retirement savings reform, which together with retirement reform measures, represent Treasury’s efforts to encourage household savings and in the long term reduce excessive debt and reliance on the state.

Implementation of the change

Section 12T has been added to the Income Tax Act. It defines a tax free investment and sets out who may own such an investment, the limits on the contributions to that investment, the tax treatment of contributions in excess of the limit and how these investments will be monitored and regulated.

The Financial Services Board will be responsible for the supervision and regulation of TFSAs.

What is a tax free investment?

Tax free investments are financial instruments such as savings accounts with banks, fixed deposits, unit trusts (collective investment schemes), retail savings bonds, certain endowment policies issued by long-term insurers, linked investment products and exchange traded funds (ETFs) that are classified as collective investment schemes, that are administered by a person or entity designated by the Minister of Finance to administer such an investment.

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Product providers, which include both the provider that issues the tax free investment and the entity that administers it, must make sure that these products are simple to understand, adequately transparent and suitable for investors.

A tax free investment may only be owned by a natural person or the deceased estate of a natural person and must comply with regulations issued by the Minister of Finance.

The final Notice and Regulations that allow for the introduction of Tax Free Savings and Investment Accounts ("TFSAs") have been approved by the Minister of Finance and were published under Government Notice No. R 1.72 in Government Gazette No. 38509 on 25 February 2015

Who may issue and administer a TFSA?

Regulation 2 of Government Notice No. R 1.72 provides that TFSAs may only be *issued* by the following regulated institutions:

(a) a registered bank;

(b) a long-term insurer;

(c) managers responsible for collective investment schemes;

(d) the government (through the retail savings bond scheme);

(e) a mutual bank, or

(f) a co-operative bank..

TFSAs may be *administered* by these regulated institutions and by an authorised user (stockbrokerage firms) and a linked investment service provider (Government Notice No. R1.72 published in Government Gazette No. 38509 on 25 February 2015).

Features of a Tax Free Investment

- Contributions to tax free investments are limited to R30 000 in total for any tax year. This means that if an investor has more than one tax free savings investment, his total contributions to all his tax free investments must not be more than R30 000 in that tax year.
- The lifetime contribution limit is R500 000. This means that an investor's total contributions to all his tax free investments, over his lifetime, cannot be more than R500 000.
- An investor may withdraw from a tax free investment at any time. Any amount received or accrued by a person in respect of a tax free savings investment shall not be taken into account in determining whether or not a person has contributed in excess of the prescribed limit. This means that any return

earned on contributions will not be taken into account in determining whether or not an investor has exceeded the contribution limits.

- Any amount received or accrued to a person through a tax free investment will not be subject to tax which means that these amounts will be tax free.
- Transfers from one tax free investment of an investor to another tax free investment of that investor will not be taken into account when calculating that investor's annual contributions to a tax free savings account. This means that any amount transferred into a tax free investment from another tax free investment will not count against an investor's annual or lifetime limit. Such transfers are however not allowed for the first year. An investor may not transfer any amount in respect of a tax free savings account before 1 March 2016.
- An investor may not transfer money from a tax free investment into any other type of investment.
- An existing investor product may not be converted into a TFSA. This means that a TFSA must be built up with new contributions from the investor, to encourage new savings. However, in a Media Statement issued on 20 February 2015, National Treasury confirmed that they are investigating the possibility of allowing an investor to convert their savings or investment in current products into tax free investments where the total amount in those products are not more than the annual limit of R30 000. This will be finalised later this year.
- An investor must be able to get payment of an amount from a TFSA within 32 business days if the investment has a maturity date or within 7 business days if it does not have a maturity date.
- No debit orders, ATM withdrawals or debit and credit card transactions will be permitted in respect of a tax free savings investment.
- A policy for a tax free savings investment may not provide for any risk cover such as disability, illness or death.
- Performance fees are not allowed.
- Both the provider that issues the tax free investment and the entity that administers it must comply with the disclosure requirements as specified under the Financial Advisory and Intermediary Services Act.

The consequences of contributing in excess of the limit

- Any amount contributed to a tax free investment over the R30 000 annual limit or the R500 000 lifetime limit will be taxed at a rate of 40%.
- Only the amount that is over the limit will be taxed at 40%.
- A product provider may not accept any contributions over the limits. It however remains the investor's responsibility to make sure that all contributions to TFSAs fall within the annual and lifetime limits. Some

insurers, like Momentum, will put measures in place to make sure that the investor does not contribute more than the allowed limits towards TFSAs at the insurer.

TFSAs with Momentum

Momentum's TFSA products were launched on 1 March 2015. For more information on these products please contact a MDS Marketing Adviser or a Wealth Business Development Manager (BDM).

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