THE NUMEROUS ADVANTAGES OF A TAX-FREE SAVINGS ACCOUNT

By Charles Savage

The tax savings over the course of your working life work out to a 35% to 40% benefit to your investment portfolio

A tax-free savings account (TFSA) is a great long-term investment opportunity for anyone looking to build wealth and save for retirement. At first glance there are some obvious benefits. Because you pay no tax on interest, dividends or capital gains tax, the savings compounded over time can substantially enhance your returns over the life of your investment. If you compare that to putting your money into a traditional savings account, though this approach may offer less risk, it will never give you the kind of returns you would see investing in exchange-traded funds (ETFs) and managed portfolios. This makes a big difference when you consider a long investment timeline.

For people under 35, opening a TFSA is an absolute no-brainer. Investing in a TFSA happens after you've been taxed on your salary. As a young earner you have two things working in your favour: a lower tax rate due to a lower income bracket and lots of time.

If you're a little older, you've had more opportunity to work and build on your income-earning potential. This might mean looking for a way to grow your assets faster, and in this instance I think more consideration may be needed. If you're someone in this group, a TFSA might work better as an addition to your existing portfolio, allowing you to invest up to R30,000 a year tax free.

Investing and risk

When people raise the issue of investing and risk, my response to them is to consider the risk they face if they don't start investing, as this has historically been proven as the most effective way to build wealth over the long term. The TFSA initiative was brought about by the South African government who, like me, want to encourage more people to save and be empowered to invest. But they also want to make sure that this is done responsibly.

To reduce your risk exposure, they have legislated that you can only invest in a collective investment scheme such as a unit trust and certain ETFs in your TFSA. ETFs track the performance of a market benchmark or index which means your risk is spread and your portfolio diversified.

A lot of people look to diversify their portfolios by ensuring a portion of their money is invested offshore. This is particularly relevant and useful when you consider the weakening rand. What some people might not realise is that there are a number of ETFs that track indices in global markets, allowing investors to gain international exposure. This also offers investors the opportunity to invest in their favourite growing global brands such as Apple, which can be found in the CoreShares S&P 500, for example.

Cost savings

One of the biggest benefits to having a TFSA has got to be its cost-saving capabilities. On average, the TFSA investor saves around 1% a year compared with alternative investment vehicles. That might not seem like a lot initially, but when you think about the effect that has over 35 to 40 years, it works out to a 35% to 40% saving on your investment, which is significant.

If you have a decent timeline to work with, TFSA's work out way cheaper than retirement annuities or pension funds.

The TFSA space is still in it's infancy in South Africa and so I think we'll see a lot of improvements and enhancements to its capabilities in the years to come. For so many parents, it's a great way to invest for their children's future and education; and as a young professional it should be top of mind when looking to start your investment journey. ■

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