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FROM THE CEO's DESK

After my last editorial, where I reported on our Asset Management team's excellent results in the Raging Bull Awards, we have some further good news. We were nominated for another award, narrowly missing the top step of the podium to the Nedbank Opportunity Fund. Our Balanced Fund of Funds was placed second, in the Moderate Allocation category. Our congratulations on this remarkable achievement, and thanks to our clients who have supported this excellent proposition!

On the local front, the economy is in "muddle along" mode, with some rather interesting twists and turns. We've had the local currency defying political gravity, supported by a global appetite for the materials we export, interest rate increases are on hold, supporting an indebted populace and businesses which are reluctant to commit cash to building capacity which would create much needed employment and confidence.

Globally, the US is set to increase interest rates, following some extremely strong employment data, indicating the US Treasury's belief that the economy is robust enough to weather this calming action. Notably there is a major dislocation between the States and the Eurozone, battling with Brexit and internal political and economic headwinds. The ECB continues a very accommodative stance and policy, and this seems to be supporting markets and certain sectors. Banking is not yet one of these and until this changes, the Eurozone remains vulnerable to volatility in asset prices. Domestic politics continues as a ready source of material for the likes of Pieter Dirk Uys and Trevor Noah! Unfortunately, the latest spate of events, including the appointment of Brian Molefe to Parliament, and the incredibly inept handling of the social security payments via SASSA to millions of beneficiaries, represent further fuel to detractors and a dangerous social risk, where the unemployed or folk in need are compromised. The devil in me asks to what extent the government dares to play this game, and why they have let this get so close to the wire? I certainly don't support a welfare state in principal, but if this payment is due and agreed, it must happen.

> "I would encourage clients with an appetite and risk/return profile that suits direct equity investments to have your NFB advisor introduce you to these services."

The sadness for me is reflected in the positive sentiment towards Emerging Markets globally, offset by the political shenanigans of countries like ours. South Africans cannot afford any 'own goals' and our politicians, notably the top dogs, seem totally disinterested as they scramble from election to election hanging on to power and influence.

We have also just heard that South Africa has not met its obligations to host the Commonwealth Games. The games are therefore lost to Durban and are likely to take place in the UK. Given our legacy of hosting the Rugby, Soccer, Cricket and other World Championships and the awesome impact this has had on South Africa Inc. makes me sad. The Minister's explanation was the government lacked the ability to risk the capital required, and cited the need to pay large amounts, in advance, to a newly registered entity. I ask why this was even allowed to happen, and was this not just another game of largesse, or even one where parties might have resisted the need for largesse? Sad that we need to even consider these, isn't it?!

So, where to next? The world remains a big marketplace. Our much-repeated mantra of "diversification, taking tactical and strategic decisions and staying the chase" remain relevant.

NFB Johannesburg has recently been joined by **Chris Lemmon**, who in fact is the Managing Director of **NVest Securities**, our in-house equity focused business and fully-fledged member of the JSE. Chris is an experienced and well-regarded stockbroker and portfolio manager. I would encourage clients with an appetite and risk/return profile that suits direct equity investments to have your NFB advisor introduce you to these services. They are top class and offer both fully discretionary as well as execution only options we would be delighted to discuss. ■

"Our much-repeated mantra of "diversification, taking tactical and strategic decisions and staying the chase" remain relevant."

Mike Estment CFP® professional
BA / Chief Executive Officer
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TAX INCREASE VS **PORTFOLIO TAX DECREASE**

2017 has certainly gotten off to an interesting start.

The rand has strengthened by 4.35% YTD against the dollar, with US markets making major gains and breaking records along the way, and of course the post budget ramifications sparking conversations whether at the braai or in the boardroom.

For the purposes of this article the focus will be on some of the noticeable changes announced in the budget speech. We will then cover three investment vehicles to reduce tax liability.

The recent budget speech delivered by Pravin Gordhan was well received by parliament as it increases taxation of the rich with the introduction of a new marginal tax rate (45%) for individuals who earn more than R1,500,000 per year. This, together with not adjusting tax brackets for inflation, will raise an additional expected R16.5 billion for government.

Also worth noting is the following from wheels24.co.za: "The Automobile Association (AA) said the increase is "cause for great concern". The AA said the additional 30 cents/l means that motorists will now be paying R3.15 towards the fuel levy for every litre of fuel they put in their vehicles, and an additional R1.63/litre for the RAF levy. The AA said: "Effectively this means that for every litre of petrol, motorists are paying R4.78, or 35 percent, on indirect taxes. This is a huge amount, and calculated on a 50 litre tank of fuel amounts to R239. South Africans already buckling because of the weak economy will now have to dig even deeper in their pockets; this at a time when many are questioning government spending."

Using the current price of a litre of 93 unleaded fuel of R13.38 inland, and R13.00 at the coast, the increases will push the price to R13.77/l, and R13.39/l respectively. This, of course, is dependent on the monthly changes to the fuel price. However, using the current figures, filling a 50 litre tank of petrol will cost R688.50 (inland), and R669.50 at the coast.

Finally, Dividend Withholding Tax (DWT) increased from 15% to 20% (an increase of 33%).

> "Making use of the different investment vehicles and benefitting from the tax efficiency of these products could drastically reduce your tax liability."

Those are some of the negatives - here are a few of the positives from the recent budget.

Noteworthy highlights from the recent budget include changes to the Tax-Free Savings Account (TFSA) with the annual contribution limit increasing from R30,000 p.a. to R33,000 p.a. allowing investors to reach the overall limit of R500,000 sooner, meaning more time in the market for your investment and more time to enjoy the effects of compound interest.

The other change, probably overlooked by most people, for those with annual incomes of less than R600,000 per annum is the ability to, on agreement with their employers, use pre-tax income to fund their children's education. Limits are R20,000 per annum for schooling and R60,000 per annum for university education. For those who can, and elect to use it, this could be an excellent tax planning tool.

As the tax burden on individuals increases so does the importance of effective tax planning. Below we discuss three key tax planning strategies.

Making use of the different investment vehicles and benefitting from the tax efficiency of these products could drastically reduce your tax liability. The structuring of a retirement annuity (RA), endowment policies for individuals as well as trusts and a Tax-Free Savings Account (TFSA) all provide tax relief when utilized correctly.

We detail each of these below.

RETIREMENT ANNUITIES

There is no Capital Gains Tax (CGT), Dividend Withholding Tax (DWT) and Income Tax within the investment allowing your contributions and returns to compound at a greater rate.
Contributions made to the investment are tax deductible and tax certificates on the contributions made are issued to the investor annually.
Current legislation makes provision for you to annually contribute 27.5% of your total taxable income received with a limit of R350,000 per year.
The tax liability will fall onto the investor when reaching his selected retirement age; with the lump sum withdrawal as well as the monthly income being deemed income and subject to income tax.

> All of the mentioned investment vehicles offer tax efficient solutions in their own way, however, when we look at the combination of these products used in conjunction for the purposes of retirement planning and drawing an income proportionately from these investments it can reduce your tax liability in retirement.

ENDOWMENTS

Endowments offer investors with high marginal tax rates the opportunity to invest in a tax efficient vehicle. Income is taxed on the four-fund approach within the policy. In the case of individuals this equates to effective Income Tax of 30% and effective Capital Gains Tax (CGT) of 12%. Dividend Withholding tax (DWT) will be levied at 20%. This means that the investor will never have to pay tax on any income or capital gains in their personal capacity as this is already taken care of. The above makes endowment products great options for individuals as well as trusts with an effective tax break of 15%.

Endowment products need careful consideration before implementing as the term is generally 5 years and certain restrictions will apply when wanting to access funds within the first 5 years of the investment.

See the table below on how the endowment structure can benefit the high marginal tax rate payer:

	Income Tax	Capital Gains Tax
Individuals	18%-45%	18%
Trusts	45%	36%
Companies	28%	22.4%
Endowments	30%	12%

TAX FREE SAVINGS ACCOUNTS

Introduced in 2015 the Tax-Free Savings Account is extremely popular. Investing in this vehicle should form part of any successful investment plan. The increased yearly allowance allows you to now invest R33,000 p.a. (increased from R30,000 p.a.) into your Tax-Free Savings Account - the lifetime limit of R500,000 remains unchanged.

All of the above investment vehicles offer tax efficient solutions in their own way, however, when we look at the combination of these products used in conjunction for the purposes of retirement planning and drawing an income proportionately from these investments it can reduce your tax liability in retirement.

The above can best be illustrated using the example below:

Let us assume that Mr. John Doe is 45 years old and plans to retire at age 65; his current portfolio has been structured making use of his Tax-Free Savings Account, an endowment and a retirement annuity.

John has reached his R500,000 limit on contributions to his TFSA and therefore cannot contribute to it anymore; he has a fund value of R500,000.

His retirement annuity (RA) has a fund value of R3,000,000. John is also making a monthly contribution of R10,000 per month toward his RA.

Lastly, John has an endowment policy with a fund value of R1,500,000 and he is also contributing R2,500 p.m. towards it.

Assumptions:
Inflation: 7%
Investment return net of fees:10%

When John retires at age 65 his portfolio will have a combined value of R52,798,520; he now needs to draw an income from his portfolio.

Drawing 5% per annum across his three investments will provide John with a monthly income in today's value of R56,851 p.m. and he will pay tax on the income received of R7,334 p.m.

John's effective tax rate in retirement, by utilizing the different investment vehicles available to him and drawing 5% per annum proportionately, is 12,9%.

If John's portfolio was structured by means of a retirement annuity only, R5,000,000 as a current fund value with John contributing R12,500 monthly, he will reach retirement (65) with the exact same fund value R52,798,520.

If John elects a drawing rate of 5% per annum from his living annuity it will provide him with a monthly income of R56,851. However, because the entire amount is subject to Income Tax he will now pay **R14,598** p.m. in tax, with an effective marginal tax rate of 25,68%.

John's tax *doubled* based on the exact same income amounts received, as he did not make use of alternative tax efficient investment vehicles available to him.

All the above-mentioned products are tax efficient in their own way and all serve a purpose in a financial plan. It is up to your Financial Advisor to guide you and construct your portfolio in the most tax efficient way reducing your tax liability at retirement.

CONCLUSION

In an ever-changing economic environment, mostly out of our own control, changes to tax rates, market performance and legislation will require a review of your current financial portfolio structure. Investors have the control - seek sound advice and guidance from your trusted Financial Advisor – and the correct structure could ultimately reduce your tax liability and provide financial security to you and your loved ones.

Should you require assistance with your retirement plan, please do not hesitate to contact one of our Private Wealth Managers at one of our NFB offices in Johannesburg, East London, Port Elizabeth, Stellenbosch or Cape Town. ■

> As the tax burden on individuals increases so does the importance of effective tax planning.

Jaco Van Zyl
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SO HOW MUCH **IS ENOUGH....**

How much is enough? Is R2million enough to retire on? How about R1million or perhaps R5million? Why are some retired people earning R10,000 per month, extremely happy and have money left at the end of the month, whereas others earning R50,000 a month not making ends meet? Perhaps, how much we need, rather than want, is a good starting point as far as income requirements go.

Retirement age in South Africa is 55 or older and often referred to as early retirement. Actual ages are mostly age 60/65 or later. The answer to: **"how much do I need?"** varies from day to day. The same person will probably have different answers six months apart. One reason is how we feel about our employment and the way we are treated. If we are content at work we probably feel that R3 million retirement capital is not enough and has to be built up. However, if our employment environment changes we might argue that R3 million is more than enough and we just have to make do with the capital available.

One simple calculation method to determine our capital need is to use our current monthly **net after tax income**, times 12, to get our yearly net income requirement, multiplied by a factor of 20. If the after tax income requirement is more than R30,000 per month, the factor is to be increased to 25 instead of 20 (based on 2017/2018 tax rates).

> **EXAMPLE:** Client aged 58; house is paid for and children out of the house. Current after tax income is R15,000 per month or **R180,000 per year**.
>
> R180,000 x 20 = R3,600,000 - capital need - if you retire today with 6% income per year.
>
> *[The calculation above is an indication only. For accurate data, discuss your retirement position with your financial advisor. Adjustments to be made for present and future values when discussing values with your advisor.]*

For starters, do not rush your decisions if you are at, or nearing, retirement age. Try to get through the current month and defer your decision to month end. Next, commit to making a decision only at year end. Go on holiday or take a few days off and reassess.

By deferring your retirement by 1 year, you gain in two ways. Firstly, your retirement capital increases with a years' worth of contributions and compound interest. Secondly, the income requirement is one year less, as you are one year older.

It also seems grand to sit at home and read the paper while having your morning coffee or tea, but what will you do during the rest of the day? Your house can only be painted, organised, cleaned and re-arranged so many times. You will soon reach the stage where this is boring, maybe in 6 months time, if that long. You need to keep active, stay engaged and even generate income. The latter should be something you love doing and you should not be forced into a position where you have to work, but rather one where you cannot wait to get going!

Do you sell your house and buy something smaller? A smaller property can save you a lot of money in the long run; for starters, municipal rates are less. Maintenance also seems to be a never-ending expense. Maybe a practical consideration would be to buy a face-brick house, as then painting on the outside is not needed every 5 to 7 years, thereby reducing the income requirement on your retirement capital.

Does money make us truly happy when things like laughter, friends, a pleasant walk, and sunrises and sunsets are free? By keeping this in mind it will help to distinguish between what we need and what we want, and influence our perceived retirement capital needs... ■

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KNOWLEDGE INTO **WEALTH**

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