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Invest with the times

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Investors bear the brunt of higher tax collection targets

The significant increase in dividend withholding tax (DWT) surprised equity investors whose tax contribution increased from 22 February.

In fact, the increase in DWT from 15% to 20%, as announced in the Budget presentation last week, undeservedly punishes individuals who exercise the financial discipline to save and invest.

One would expect government to support and encourage savings and investments, especially since South Africa has one of the lowest savings and investment rates in the world. According to the South African Reserve Bank, South Africa's domestic savings rate is a miserable 1.7% of the gross domestic product. This contrasts with other developing countries like China, India and Turkey where the domestic savings rate is more than 20%.

It is assumed that government chose to increase DWT because it is easy to collect. The withholding agent simply deducts the DWT before paying dividends to investors and pay the amount to SARS.

How do we compare with the world?

It is significant to note that at 20%, a developing economy like South Africa is moving closer to the dividend withholding taxes of developed economies like Canada 25%, Germany 25%, France 30% and Israel's 30%.

This in contrast to countries showing positive growth and job creation data like Singapore and India where investment is encouraged and no DWT is applicable.

How does this affect your investment?

Investors in Class A and C receive monthly dividends, now taxed at 20% rather than 15%. A person who invested R100 000 in Class A, for example, will in future pay R38 more tax each month. In Class C the difference will be R56 per month.

Investors in Class B could be liable for capital gains tax at the end of the investment term and are not affected by the budget announcement. Capital gains tax has been left unchanged. The inclusion rate for individuals is still 40% and the exclusion amount is R40 000. After five years an investment of R100 000 in Class B will be worth R170 000. If a personal tax rate of 41% is assumed, the capital gains will be R4 920. (R70 000 - R40 000 = R30 000 x 41% x 40%).

Tax-free savings

The increase in the tax-free savings account contribution amount – from R30 000 to R33 000 – is a welcome gesture. It is regrettable that the amount wasn't increased by more as an incentive for people to save and invest. However, you can now invest R2 750 per month in a tax-free product, although the maximum of R500 000 still applies over a taxpayer's lifetime.

Super tax

The increased tax rate of 45% for the super rich, who earn more than R1.5 million per year, will increase South Africa's tax revenue by an additional R4.4 billion. Ironically, a mere 50 basis point increase in the VAT rate would have added more than R10 billion – twice more than the super rich tax – to treasury's coffers. An increase in VAT is perceived to be politically insensitive however, which is why it remained unchanged at 14%.

The new rate of 45% is the highest tax rate since 1994 and about 100 000 South Africans will be affected. There is also concern that many people might suddenly find themselves in the category of super tax, owing to bracket creep. This year the income brackets were increased by only 1%, while most salaries increase at least in line with inflation of about 6%.

Property gets a boost

If you compare the various asset classes available to investors, real estate benefits most from this budget.

The increase in the threshold level of transfer duty on property from R750 000 to R900 000 will help first time property buyers and people who are downsizing and buying smaller homes.

Is credit downgrade imminent?

Rating agencies will be happy to see that the fiscal deficit is being reduced, albeit at a slow pace. A consolidated fiscal surplus (revenue minus non-interest expenses) can be a reality towards the end of the year. This means that public debt could reach its peak (as a percentage of GDP) next year. However, there is an urgent need to make structural changes and get the economy back on track.

The rating agencies reconsider SA's foreign debt in June. Neither Standard & Poor's nor Fitch is expected to change their "negative" view to "stable". Given the weak economy and tense political environment a downgrade could still be on the cards later this year.

Financial dysfunction?

Why do smart people put their financial destiny in the hands of others, instead of taking control of their own financial future?

Do you speculate or invest?

If you speculate, you cannot measure your investments' progress to determine if you are reaching your goals or not.

You are a speculator if you make money during some months and lose it again during others. You lose patience, start to panic and seek other ways to make money quickly, taking up and abandoning investment plans randomly with no solid strategy – the classic state of financial dysfunction.

You can however take control of your investments and financial future.

What is a real investor?

A true investor is neither passive nor reckless, but follows a strategy based on informed decisions. He or she does not follow the flock and realises that the best investment options are not necessarily offered by major insurance/investment houses. It is often better to invest with smaller organisations specialising in niche markets where low, or even no costs are applicable.

All that is needed is a basic investment plan and financial discipline. Every plan has a price in terms of time spent. Once you realise this, you will be on the road to achieving financial success.

Resist hasty decisions and promises of instant riches, but instead be systematic and patient. Take time to draw up a financial plan and pursue it diligently so that your money can work for you.

A magic formula to wealth?

Many people seem to believe there is a secret, magic formula to becoming a wealthy investor. They believe that good investments are complicated and only available to a select few who can make money from investing.

Keep it simple

It has been proven time and again that a simple investment plan is the best. So forego a plan filled with elements of excitement and danger. Rather stick to a simple strategy and only invest in what you fully understand.

Select carefully

All investments are not suited to everyone, yet we tend to choose those options that are familiar to us. Bear in mind that the range of investment options on offer has changed tremendously over the years and we have myriad choices. Examine new possibilities instead of just relying on the familiar. One such example is endowment policies, especially the older generation types that could contribute to dysfunction.

Over the past few decades, life insurers have offered endowments that combined life insurance and investments. The portion devoted to life insurance would then gradually increase, leaving little to go towards the investment. In the process many have been left disillusioned by the maturity values of their endowments.

Another disadvantage of endowments is the massive penalties you incur for cancelling contributions before the end of the policy term. This is not unlikely as you may need access to the funds or be unable to afford the premiums.

Tax on an endowment policy can exceed that of a direct investment. With a direct investment there are interest exemptions for individuals and the investor is taxed at a marginal rate as low as 18%. Compare that to a policy where the funds are taxed at 31% and no tax exemption is applicable.

Ironically, a policy is often marketed as being tax-free in the hands of the investor, while in reality the applicable taxes are paid to SARS before the returns hit your pocket.

In addition, the financial advisor earns as much as 5% commission, paid upfront for the entire investment term. If you add these hidden costs, endowment policies can be expensive investment products that will not generate wealth. Hence it is a typical example of a dysfunctional investment.

Father Time

Finally, time will prove the efficacy of your investment choice – its security and acceptable net returns (i.e. after costs and taxes) - and you will be able to decide whether you want to continue investing in it. This is when you have the opportunity to earn growth on growth and create wealth!

Consider Ecsponent's investment options. It offers a simple investment structure in preference shares that offer a fixed rate. Class A and C provide a monthly income, which is predictable based on a dividend calendar that states when and how much you will earn for the next twelve months. Dividends are paid punctually each month.

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