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5 Ways to save Tax in Retirement

Tax plays an important role in planning towards retirement and in retirement. All too often a significant amount of time is spent before retirement in only making use of the "traditional" pre-retirement tax saving mechanisms. Retirees however still find themselves short-changed in retirement as tax reduces their monthly income to less than their targeted living expenses or just keeps eating away at their hard-earned retirement savings.

The traditional mechanism used to reduce tax, pre- and post-retirement is contributions to a retirement annuity. Up to 27,5% of your income (to a maximum of R350 000) per annum can be contributed towards a retirement annuity, this is deductible from your taxable income and in effect reduces your taxable income and the tax payable. You can continue contributing towards a retirement annuity in retirement, as there is no maximum age cap for a retirement annuity.

There are many more effective strategies to reduce tax in retirement, these specifically focus on reducing your taxable income in retirement and using other sources of income. Here are five strategies that can save you thousands of taxes in retirement and increase your disposable income:

1. Share the load

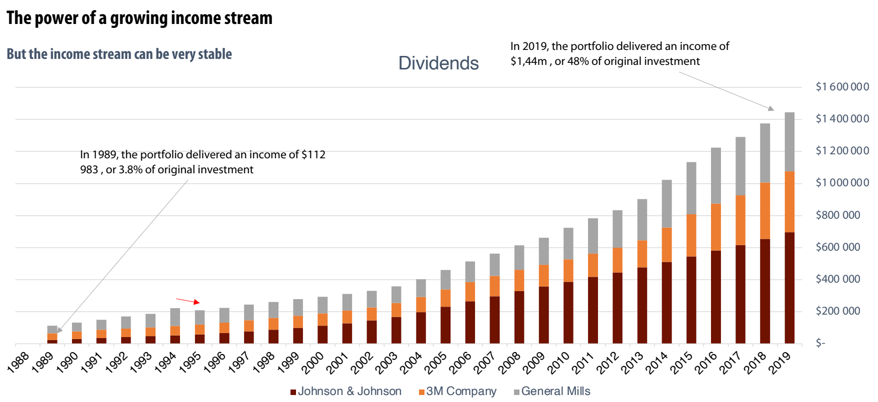
In planning towards retirement, it is important to plan for both spouses and partners. By splitting the retirement income effectively across spouses, you can significantly reduce your post retirement tax. It is also important to use the strategies mentioned below for both spouses/ partners in pre-retirement planning.

2. Build up your tax -free savings long before retirement

Tax free savings remain an extremely useful planning mechanism. By starting your tax-free savings long before retirement, you can build up meaningful capital that can be used in retirement to provide tax free income. Up to R36 000 per annum can be invested in tax free savings investment up to a lifetime limit of R500,000. It takes approximately 14 years to contribute up to your lifetime limit, so it is important to start early so that the investment grows into a meaningful amount by the time you reach retirement. Also maximise this benefit between yourself and your spouse or partner and ensure that you get a decent return on this. It is of little use investing in a tax-free savings account in cash or interest-bearing assets (in your bank) as this does not allow your money to grow over time to create meaningful wealth in retirement. In starting contributions to tax free savings 14 to 15 years before retirement you can accumulate approximately R1,5 million over that time by investing in a balanced fund, this can provide R3m of capital for tax efficient income for a couple at retirement.

3. Invest in a dividend biased portfolio

A high yielding dividend portfolio is an extremely effective strategy in building up retirement capital and reducing tax in retirement. The appealing characteristics of a high dividend strategy is that company earnings (and your dividend income) generally grow ahead of inflation, this is exactly what you need in retirement, to protect you against medical inflation which has grown at a rate significantly higher than inflation. The earlier you start investing in a high yielding dividend portfolio the better as you allow both your capital and dividend income to grow over time. This is best illustrated by an example of investing in a high yielding offshore dividend portfolio over a long period of time.



Dividends grew by 8.9% per year (only one year of decline) compared to US CPI of 2.4%

Had you invested in a few "boring" but stable international companies that continue to grow their earnings year in and year out such as Johnson & Johnson, 3M and General Mills the portfolio would have delivered a dividend income of 3,8% in the first year growing to 48% dividend income 30 years later (remember this is the time frame for most retirees !). This is an extremely powerful retirement planning strategy, and even though it can be applied in retirement it should ideally be started long before retirement.

4. Use your discretionary investments wisely

Discretionary investments are those investments that are not invested in a retirement wrapper i.e. your investments outside of your pension fund, provident fund and retirement annuity. For most people this would normally include unit trusts, savings or bank account and shares. These investments can be used to further augment your income in retirement, this is done through "repurchasing" of units which can be implemented as regular monthly payment by most administrators of these investments. Structuring this income needs to be done within the context of your annual Capital Gains Tax exemption (R40 000) per annum.

5. Retirement annuities has some benefit

Retirement annuities are probably sold for the wrong reasons in retirement and often serve the salesperson and not the retiree. Using a retirement annuity in retirement may require drawing a higher income to pay for this "benefit". Even though there is a small benefit, due to the" tax subsidy", if not structured correctly this benefit can be completely eradicated by the commission and fees. The table below consider various scenarios using these strategies to deliver a more tax effective post retirement income

Description	Base Case 5% Income no RA	Scenario 1 6,88% Income with RA	Scenario 2 (Living annuity + Dividends)	Scenario 3 (Living annuity + Dividends + Tax Free Savinng)
Annuity Income	R 40 000	R 55 048	R 20 000	R 20 000
Retirement Annuity Contribution		R 15 138		
Taxable Income	R 40 000	R 39 910	R 20 000	R 20 000
Tax Payable (SARS Tabels)	R 7 929	R 7 839	R 1 908	R 1 908
Estimated Tax Rate	20%	14%	10%	10%
Income after Tax	**R 32 071**	**R 32 071**	**R 18 092**	**R 18 092**
Dividends after dividends witholding tax			**R 14 000**	**R 4 666**
Discretionary Income plan				**R 4 666**
Tax free income (Tax Free Savings and others)				**R 4 666**
Total Income Received	**R 32 071**	**R 32 071**	**R 32 092**	**R 32 090**
Annual Tax Payable (SARS Tables)	**R 95 147**	**R 94 067**	**R 22 898**	**R 22 898**
Annual Tax Saving		**R 1 080**	**R 72 249**	**R 72 249**

There are a lot more effective ways to save tax in retirement than investing in a retirement annuity. All of these have an objective of augmenting retirement income with more tax efficient sources of income including income from tax free savings, dividends, and discretionary investments. These strategies should ideally be implemented long before retirement.

Should you want to discuss further contact:

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