Demystifying Retirement Planning Lingo

by O'Hagan Attorneys **| May 31, 2024 |** Retirement Planning **|** 0 comments

We all dream of a happy retirement, but making it a reality requires early planning. A good rule of thumb is to stash away at least 15% of your pay check before taxes right from the start of your career.

Depending on your situation, this might involve diving into some or all of the following:

Pension funds: Saving smart with tax perks

The superheroes of retirement planning in South Africa, pension funds are often set up by your employer. Putting money into these funds can lower your taxable income, meaning less money goes to the taxman. Plus, any growth your investments make is tax-free, helping your savings snowball over time. This combination of financial stability and tax perks makes pension funds a solid choice for retirement savings.

When you retire, you can usually take out a chunk of your savings in one go, up to about a third. The rest must be used to buy an annuity, which pays you a regular income throughout your retirement. But watch out: if your lump sum is over R 550,000, lump-sum taxes apply, and the annuity income gets taxed, too.

Provident funds: Getting in line with pensions and taxes

Traditionally, the key difference between pension funds and provident funds was that provident funds let you withdraw all your cash when you retired. However, recent changes have brought them closer to pension funds, especially regarding taxes and withdrawal methods. Keeping up with these changes is essential to maximising your retirement savings.

Retirement annuities: Tailored savings with tax breaks

Retirement annuities empower you to customise your retirement savings plan to fit your life. Unlike pension or provident funds, you don’t need to be tied to a specific job to set one up. This flexibility means you can shape your retirement plan to suit your goals and needs, giving you the power to design your financial future.

Putting money into retirement annuities not only secures your future income, but also offers tax benefits. It can lower your taxable income significantly, providing some relief while you're working. When you retire, only a portion of your savings can be taken out in one go, usually up to a third. The rest goes toward buying an annuity to keep the cash flowing during retirement, ensuring a steady income stream while also managing your tax obligations.

Tax-free savings accounts: Adding flexibility to retirement savings

In addition to the usual retirement funds, you can also stash cash in tax-free savings accounts. You can put in up to R36,000 annually, with a lifetime limit of R500,000 per spouse. Any growth, like interest, is tax-free.
Unlike other retirement funds, you can dip into your tax-free savings whenever necessary without worrying about taxes. This flexibility can come in handy for short-term goals or unexpected expenses. Just be careful not to exceed the yearly or lifetime limits, or you might face some tax penalties.

More options

There's nothing stopping you from investing in shares or unit trusts as part of your retirement plan. The advantage is that you can allocate the entire amount offshore, but you don't receive the tax benefits of the other retirement products.

The times they are a-changin'

The two-pot retirement system, which comes into effect on 1 September 2024, will simplify things by splitting your retirement savings into two main pots:

1. **Preservation pot:** This holds funds meant for long-term retirement savings. Most of the money you put into pensions, provident funds, and retirement annuities goes into this pot. You can't touch this money before retirement age, so it stays put for your golden years.
2. **Access pot:** This pot gives you some wiggle room, allowing you to tap into part of your retirement savings for short-term needs or emergencies. It includes money from pension and provident funds, but there are rules about when and how much you can take out. While having access to this pot can provide some financial relief in a pinch, it's essential to keep an eye on your overall retirement savings.

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