RETIREMENT PLANNING: COULD TAX AND FINANCIAL LITERACY INCREASE FINANCIAL INDEPENDENCE DURING RETIREMENT?

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ABSTRACT

RETIREMENT PLANNING: COULD TAX AND FINANCIAL LITERACY INCREASE FINANCIAL INDEPENDENCE DURING RETIREMENT?

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Recent studies have indicated that only 6% of South African citizens can maintain their standard of living during retirement. This is of great concern to both the government and individuals. In an attempt to counter this dilemma, the government has implemented several new tax exemptions and deductions to encourage taxpayers to increase their retirement savings.

However, uncertainty exists regarding the effectiveness of these exemptions and deductions. For individuals to benefit from same, they will need to be informed on and understand the principles on which they are based. Above all, South African citizens need to grasp the importance of ensuring their financial security during retirement, which will hopefully create a culture of saving for that purpose. South Africans therefore need to increase their level of financial and tax literacy, either by informing themselves in that regard, or by consulting with professionals.

This study was conducted from a South African perspective and focused on the probability of financial and tax literacy increasing financial independence during retirement. The data presented in this study was collected by means of two questionnaires, which were emailed to a selection of participants. The purpose of this study was first to determine the financial and tax literacy of South Africans with regard to retirement planning and second, to determine whether financial and tax literacy could increase financial independence during retirement. This study is an empirical study since primary data was collected specifically for this research project.

Based on the data obtained by means of the questionnaires, it was concluded that the financial and tax literacy of the majority of South Africans is not sufficient to intentionally benefit from tax-beneficial retirement funds and investments. It was further concluded that although the majority of South Africans are not sufficiently financially literate to be able to optimise their retirement savings, they are willing to improve their level of financial and tax literacy and increase their savings towards retirement once they have been informed and have gained some understanding in this regard. Therefore, financial and tax literacy can potentially increase financial independence during retirement.

Key terms:

Financial literacy

Tax literacy

Financial independence

Retirement savings

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Table 1: Abbreviations and acronyms used in this document

Abbreviation	Meaning
The Act	Income Tax Act No. 58 of 1962
SARS	South African Revenue Services
GDP	Gross Domestic Product
IFRS	International Financial Reporting Standards

CHAPTER 1:
INTRODUCTION

BACKGROUND

Research (Lamprecht, 2015:1) has revealed that only 6% of South Africans are able to maintain their standard of living during retirement. It is therefore understandable that in his budget speech of 2012, the Minister of Finance emphasised the need for South Africans to save more for retirement. Subsequently income tax legislation was amended to provide for several new exemptions and deductions in an attempt to encourage taxpayers to increase their retirement savings. In the 2013 budget speech, it was proposed that tax deductions for employee contributions to pension, retirement annuity and the newly included provident funds should be harmonised and increased to 27.5% (National Treasury, 2013b:18-19). Moreover, tax free savings and investment accounts were also proposed.

In 2014, National Treasury announced that the so-called tax-free savings account would be implemented in 2015 in terms of section 12T of the Income Tax Act No. 58 of 1962 (hereinafter referred to as ‘the Act’) (National Treasury, 2014:18). A tax-free savings account will serve as a vehicle for South African residents to make contributions to a savings account from their post-tax salaries. However, contributions will be limited to R30 000 per year and R500 000 over a lifetime. The benefit provided by the tax-free savings account is that all the returns, income and capital of nature will be exempt from income tax. Moreover, the funds will be available from several financial service providers, including banks. The savings contributed to these accounts will be available for withdrawal at any time (this will, however, reduce the lifetime limit) (Kensley, 2015:2).

Considering the benefits of a tax-free savings account and the way it works (as discussed above), it has been suggested that the rationale behind the tax-free savings account is to encourage individuals to save for short- and medium-term needs, rather than to rely on their retirement savings (Kensley, 2015:3). However, this is in contrast with the views of other expert financial advisors, who have expressed the opinion that investing for short periods is one of the main pitfalls of the account, and that the further away you are from retirement, the more sense it makes to use tax-free savings (Mittner, 2015:4).

Uncertainty and concerns about the way in which the harmonisation of provident funds would be implemented delayed the implementation of the retirement reform until 1 March 2016. Since it had not previously been a requirement to annuitise provident fund pay-outs, the annuitisation requirement of provident funds was postponed even further until 1 March 2018 (National Treasury, 2016:1). However, from 1 March 2016 taxpayers will be allowed a deduction of 27.5% of the greater of taxable income or remuneration, up to a cap of R350 000 for contributions to all retirement funds (including provident funds).

According to the National Treasury, the retirement reform will limit the tax deduction available to individuals who earn very high incomes and allow lower- and middle-income earners a bigger tax deduction (National Treasury, 2016:2). This is an interesting statement as individuals who earn up to R1 272 727 per year will still qualify for the full R350 000 deduction. Furthermore, the reform will allow income earners who fall within the 41% tax bracket (annual income above R701 301, based on the 2017 year of assessment) to contribute R1,69 (due to the deduction) for every R1 previously held after tax, whereas income earners who fall within the 18% tax bracket (below R188 000 – 2017 year of assessment) will be able to contribute only R1.21 (due to the deduction). A study conducted by Heim and Lurie (2012:283) indicates that tax incentives in the United States of America resulted in more significant contributions by higher-income earners. Moolman's (2015:52) study led her to conclude that 'the cost of living' is the main reason for South Africans' inability to save more for their retirement. This therefore indicates that the majority of South Africans simply do not have funds available to save more. However, in order to qualify for the bigger deductions offered by the new retirement reform, lower-income groups will have to contribute more to retirement funds. If one considers the fact that these would most likely be the groups that will not be able to contribute more, it becomes clear that they will not be able to benefit from the deductions. The granting of tax incentives is not a revenue-raising activity (Jens & Roach, 2012:21).

In order to benefit from tax incentives, a person needs to be aware of and understand the benefits that are available. Moolman (2015:56) interviewed 20 South Africans and concluded that they were generally not aware of the new proposed tax incentives relating to retirement funds. However, when informed thereof, 80% of the participants indicated that they would be willing to increase their retirement savings (at that stage the implementation of said incentives was merely a proposal, which could explain why the participants were not aware of them). Moreover, of the 80% that indicated that they would be willing to invest more, 14 (87.5%) indicated that the high cost of living was their main reason for not saving more towards their retirement (Moolman, 2015:42). This raises the question of whether the participants had really understood the concept of the proposed tax incentives. Furthermore, how would they respond to the incentive as it is now implemented and realise what it actually involves? Both the participants' ignorance regarding the proposed tax incentives and their interpretation or understanding thereof could probably indicate that South African residents are generally ill-informed about tax incentives and financially illiterate in this regard.

One of the concepts or principles best understood by a financially literate person is 'financial independence'. This term is generally used to describe the state of having sufficient personal wealth to live without having to work actively in order to afford basic necessities (Cummuta, 2009:15). Two of the participants in Moolmans' study (2015:43) indicated that it was more important to first achieve financial stability and pay off debt than to save for retirement. When the participants who had indicated that the tax incentive would not encourage them to save more were asked to give reasons for their answers, the majority indicated they first wanted to become financially independent. This confirms that they did not actually understand what it meant to be financially independent. Owning a house and being debt free merely means that although one's expenses will be less, those who only receive income from a salary would still be wholly dependent on that income and would therefore not be financially independent. When asked to indicate the single most important factor that would encourage them to save more, given the choice between 'financial security and independence' and 'the growth of their investments' (regardless of tax incentives), almost 70% of the participants' chose financial security and independence. Less than 10% indicated that the single most important factor that would encourage them to save was the growth of their investments as a result of their increased savings (Moolman, 2015:48). This led to the conclusion that although 70% of the participants indicated a desire to be financially independent, less than 10% understood how this could be achieved.

Other ways in which South Africans attempt to gain financial independence is by investing in equities, unit trusts and other financial instruments. This approach is challenged by individuals who point out that recent studies have indicated that 75-80% of active managers of South African unit trusts fail to beat the common index benchmark, i.e. the average performance (Du Toit, 2014:2). This has led to investors opting to obtain financial independence by rather investing in property.

However, before South Africans will be able to succeed in planning their financial independence, they will need to understand the concept and its importance and purpose. Furthermore, they need to enable themselves to become financially independent. It is therefore clear that South Africans will only be able to make use of tax incentives and reliefs to increase their financial independence once they fully understand and are able to apply the different tax reliefs and investment options available to them.

1.1 PROBLEM STATEMENT (OR RATIONALE FOR THE STUDY)

Compared to the previous generation, South Africans today live in a world fraught with financial complexity and challenge (Struwig, Miemie & Plaatjies, 2013:1). Lamprecht (2015:1) points out that according to recent studies, only 6% of South Africans will be able to maintain their standard of living during retirement. The rest will be dependent on their families or friends, or the government. Furthermore, according to Old Mutual’s Savings and Investments monitor (2014:16), only a quarter of South Africans between the ages of 18 and 30 are saving for retirement. The South African Savings Institute provides a number of reasons for the low savings rate in South Africa, which include low disposable income growth, low employment growth, a rising tax burden, an inflationary environment and – last but not least – a lack of confidence in the future (Le Roux, 2015:5).

The abovementioned reasons seem to confirm Moolman’s (2015:52) recent finding that the high cost of living is the main reason for South Africans’ failure to save more for retirement. These conclusions are however based on the opinions of the South Africans who were interviewed and surveyed. When considering that South Africans save only 15.4% of the country's GDP, as opposed to the 50% of GDP saved by the Chinese, who earn less than South Africans, one cannot help but wonder if the cost of living really is the main reason for the poor savings habits of South Africans. Cost of living is, after all, relative to the consumer, and in many cases consumers should be able to decrease their expenditure. Other countries whose citizens manage to save a higher percentage of their GDP than South Africans are India (approximately 30%), Brazil (25%) and Australia (22.5%) (Le Roux, 2015:10). It therefore seems that there are two factors that drive savings: the ability to save and willingness (motive) to save.

When one thinks about people's ability to save, it is generally accepted that this refers to them having sufficient income, even though income is only one of the variables to be considered. If this is presented as an equation, a more accurate statement would be: Income less tax, less expenditure = possible savings; or when investing in certain funds that provide for tax incentives: Income less expenditure = possible savings. Furthermore, the ability of people to create income, to plan and structure their financial affairs and reduce spending could also be included in this equation and could increase their ability to save. It has been said that a sure way to ensure financial security or independence in life is not having enough savings, but having enough ability (Le Roux, 2015:25).

It is interesting to note that, according to Statista (2014), 23% of South Africans between the ages of 25 to 34 have failed to attain a high school qualification. The corresponding figure for Australia is 13%, and for China and Brazil it is 64% and 39% respectively. This confirms that the ability to save does not depend solely on income, literacy and education, but also on a willingness to save. According to the Old Mutual Savings and Investment monitor (Le Roux, 2015:13), South Africans spend 68% of their income on consumption or living expense, 12% on paying debts, 5% on insurance and medical aid and 15% on savings. Therefore 80% of South Africans' income is spent on consumption and debt.

Efforts to encourage the development of a culture of saving among South Africans will be influenced by several factors, which will need to be addressed. It will, however, be difficult to build such a culture unless the concept and its purpose and importance are fully understood. According to Mwandiambira (South African Savings Institute strategist), saving is an integral part of financial literacy; therefore the availability of tax incentives, tax-free savings accounts and other resources and benefits are unlikely to enhance a nation's savings culture unless a concerted effort is made to improve the general population's financial and tax literacy.

1.2 RESEARCH OBJECTIVE

The following objectives will guide the study:

- To determine the financial and tax literacy of South Africans, regarding financial independence during retirement.
- To determine the extent to which South Africans are willing to save, and whether their ability and willingness to save will increase once they have gained gain a better understanding of tax and financial concepts and principles.
- To conclude whether tax and financial literacy can increase financial independence during retirement.

1.3 RESEARCH QUESTIONS

The following research questions will guide the study:

- To perform a literature review to identify principles and concepts that relate to financial independence, and to determine how tax literacy and financial literacy play their respective roles.
- To conduct a literature review to determine what prior studies have found regarding South Africans' understanding of financial and tax literacy.
- To administer two questionnaires to determine educated and literate South Africans' level of understanding of tax and financial literacy, and to establish whether these South Africans are likely to be able and willing to save more once they have gained a better understanding of tax and financial concepts.
- To obtain a better understanding of South Africans' reasons for not saving enough for retirement.

- To establish whether improved tax and financial literacy might lead to increased saving by South Africans, which would increase their financial independence during retirement.

1.4 CONTEXT AND UNITS OF ANALYSIS

This study was aimed at determining the extent to which literate, educated (higher education) and working South Africans who earn a monthly income (any income) make provision to ensure their financial independence during retirement, and the roles played by tax and financial literacy in this provision. The initial focus was on a review of previous studies in order to obtain a clear understanding of the concepts and context. Those concepts and the context were therefore applied when compiling questionnaires aimed at educated, literate and working South Africans. The rationale behind this method was to obtain a more focused result and conclusion due to the wide range of factors that could influence the behaviour of different groups.

1.5 IMPORTANCE AND BENEFITS OF THE PROPOSED STUDY

Compared to the previous generation, South Africans today live in a world of great financial complexity and challenge (Struwig, Miemie & Plaatjies, 2013:1). A recent study indicated that a mere 6% of South African citizens are able to maintain their standard of living during retirement; the rest are dependent on their families or friends, or the government (Lamprecht, 2015:1).

These statistics are a cause for concern for both individual South Africans and the South African government, and have led to the recent introduction of the new retirement reform and tax-free savings accounts. The effectiveness of these tax incentives is however questionable. By determining exactly why the abovementioned incentives are not being effectively utilised, both individuals and the government could be assisted in moving a step closer to a wealthier and more financially independent retirement status for South Africans.

Unless the reasons and obstacles that are currently preventing South Africans from saving more can be identified, the introduction of tax incentives to encourage individuals to save more towards their retirement will not have the desired result. Even though these incentives could indeed help South Africans to save more, they first need to grasp the concept and importance of financial independence. Furthermore, they need to inform themselves and improve their understanding of tax and financial concepts and principles, tax incentives and formal financial vehicles in order to be able to create a culture of saving.

The aim of this study was therefore to obtain a better understanding of South Africans' reasons for not saving enough for retirement, and to determine whether improved tax and financial literacy could increase the financial independence of retired South Africans. South Africans and the South African government could both benefit from a better understanding of the factors that prevent South Africans from saving more. A better understanding would enable South Africa to implement focused action plans to create a wealthier and financially more independent environment, especially during retirement.

LIMITATIONS AND ASSUMPTIONS

Delimitations of the study

As stated in the section 1.4 (Context and units of analysis), a wide range of factors could influence the behaviour of different groups of people. Therefore this study will focus mainly on South Africans with a higher level of education who earn a monthly income of some kind. Even though this study might mention and consider other groups that are related to, and may in some ways be similar to the group on which the study focuses, no attempt will be made to obtain a conclusion on those groups.

Moreover, the study focused only on South Africans between the ages of 18 and 40 as the researcher felt that findings on this group would be most applicable and valuable.

Assumptions

For the purpose of this study, the following assumptions were made:

- That the combination of a literature review and interview research would provide the most comprehensive insight regarding South Africans' level of understanding of tax and financial literacy, and this would be the most effective strategy for determining their actions and attitude with regard to saving for retirement
- That the participants in the survey would answer the questions truthfully and disclose the information required
- That the participants understood and grasped the scenario's that was sketched in the survey
- That participants from different backgrounds and industries would give a comprehensive and objective view of the general population with reference to the focus group
- That the research would be most applicable to the selected age group (18–40 years) and that they could derive the most benefit from the findings
- That the participants did not include any retired persons and that they were actively working for incomes received monthly
- That the assumptions used in the illustrations and examples indicate realistic and relevant results

As the study progresses, further assumptions of which the researcher is currently unaware may be identified.

RESEARCH METHODOLOGY

In order to provide a more complete picture of the phenomenon, a mixed-method design will be applied for the research (Leedy, 2010; 97). The research aims to establish the tax and financial literacy among South Africans. The approach will be to review, assess and apply the findings of prior studies and combine them with data obtained from the questionnaires to arrive at a comprehensive understanding of the phenomenon being investigated.

The research seeks to determine the attitude of South Africans towards saving for their retirement and to understand why people are currently saving, not saving, or/and not willing or able to save more.

Initially a literature review was conducted to establish the findings of prior studies on this topic. This was then followed up by using a questionnaire to conduct survey research in order to compare findings and obtain a more comprehensive and focused conclusion. The outcome was then used to develop a second questionnaire to determine whether South Africans with a higher level of tax and financial literacy were likely to change their attitudes and actions with regard to saving.

The literature review provided background information on the different views and attitudes of South Africans, which were investigated and analysed to determine the accuracy and correctness thereof. The approaches could be tested against each other and also against statistics and other information that could be used to formulate a conclusion.

Finally, the findings were used to determine whether the conclusions indicated that tax and financial literacy could indeed change the attitudes of South Africans and motivate them to save, thereby increasing their financial independence during retirement.

STRUCTURE OF THE MINI-DISSERTATION

The main outcomes of this study are presented in the format of a mini-dissertation. The structure of this mini-dissertation is explained and summarised below.

Chapter 1: Introduction

Chapter 1 contains an overview of the introduction and background, which form the base of the study. It also presents a problem statement, the research objectives, the research questions and a summary of the context and units of analysis. The delimitations and assumptions, and the importance and benefits of the research are also discussed. The chapter concludes with a brief summary of the research design and methodology.

Chapter 2: Literature review / Theoretical constructs

Chapter 2 establishes and explains the current issues relating to financial independence during retirement. The literature review provides information on prior studies that dealt with similar issues, interpretations, perspectives and their applications. Previous studies are scrutinised and analysed in order to obtain knowledge and a sound understanding of the topic. The findings are tested against each other and against other sources that deal with similar concepts to determine their accuracy and correctness. This provides clarity on what will be evaluated in this study and forms part of the theoretical basis for the conceptual guide developed in the study. Subsequently an attempt is made to establish South Africans' current financial and tax literacy; their attitudes towards saving for retirement; the factors that drive decisions to save or not save more for retirement; what the benefits of financial and tax literacy are; and how these benefits could help people to increase their financial independence during retirement.

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Chapter 3: Research design and methods

In Chapter 3 the research methodology used in the study is discussed. A detailed description is given of the methods used for data collection, the application of the information obtained and the context and unit of analysis. Both qualitative and quantitative research methods are used, which indicates a mixed-method design.

Chapter 4: Data analysis

Chapter 4 explains the method used for analysing the data obtained from the case study (questionnaires) and other research described in Chapter 3, and the measures that were applied to determine the accuracy and correctness of the information that was used during the current research.

Chapter 5: Conclusion

The findings of the research are presented in Chapter 5. The limitations of the study are also discussed and suggestions are made for future related research.

CHAPTER 2:
LITERATURE REVIEW / THEORETICAL CONSTRUCTS

2.1. INTRODUCTION

The aim of this chapter is to establish and explain the current issues relating to financial independence during retirement. The literature review provided information on prior studies that dealt with similar issues, interpretations and perspectives, and their application. Previous studies are scrutinised and analysed in order to obtain a sound understanding of the issues dealt with. The accuracy and correctness of their findings are tested against each other, as well as against other sources that deal with similar concepts. This provides clarity on what will be evaluated in this study and forms part of the theoretical base for the research. Subsequently an attempt is made to establish South Africans' current financial and tax literacy, their attitudes regarding saving for retirement, and the drivers behind their decisions to save more, or not save more for their retirement. The benefits of financial and tax literacy and how they could be used to increase financial independence during retirement are also discussed.

The remainder of this chapter will address the following areas:

- The concept, purpose and importance of financial independence during retirement
- The culture, ability, willingness and attitude of South Africans with regard to saving for retirement
- Background and overview of the tax expense savings made available to South Africans by way of different retirement fund vehicles, and their advantages and disadvantages
- Background information on current issues relating to tax incentives and saving towards financial independence during retirement
- The financial (including tax) benefits attached to saving for retirement
- Financial and tax literacy of South Africans
- The drivers behind the decision to save or not to save for retirement

- Prior studies that dealt with similar issues and their interpretation, perspectives and application

2.2.1. Overview

The term financial independence is generally used to describe the state of having sufficient personal wealth to live, without having to work actively for basic necessities (Cummuta, 2009:15). Statistics indicate that only 6% of South Africans will be able to maintain their standard of living during retirement (National Treasury:2015:13), which is a strong indication that South Africans either do not understand the concept and the importance of financial independence or, if they do, lack either the ability or the will (motive) to save for their retirement. The 2014 Finscope survey indicated an increase in the number of salaried adult South Africans in 2014. The survey found that of the 78% of the adult population that had average personal monthly incomes of less than R2 000 in 2014, only 44% had any long-term savings or retirement products, with only half of those saving through formal channels.

The term savings is perhaps one of the most misunderstood terms in finance. According to Wikipedia, it refers to income not spent, or deferred consumption. This implies that it will only be possible to save if any part of the income is left once expenditures have been deducted. However, the fact that money is available does not necessarily imply that it will be saved. In his blog (2015), Gerald Mwandiambira (Chief Strategist of the South African Savings Institute), states: *'Before you embark on "savings" you may need to "save"'*.

Therefore, when considering the ability to save it does not merely refer to 'having sufficient income' (which in any case is a relative concept), since income is only one of the components that need to be considered. In order to save, it might be necessary to reduce one's expenses, and expenses also include one's tax expense. This can be more clearly explained by the following equation: Income, less tax expense, less consumption expenditure = possible savings. Alternately, when investing in certain funds that provide for tax incentives: Income less consumption expenditure = possible savings. The ability to create income, plan and structure your financial affairs in the most efficient way and reduce spending, and the willingness to save can also be included in this equation and could increase a person's ability to save. It has been said that a sure way to achieve financial security or independence in life is not to have enough savings, but to have enough ability (Le Roux, 2014:25).

The Old Mutual Savings Monitor (Le Roux: 2015:19) stipulates that only two things drive savings: the ability to save and the willingness to save. This literature review evaluates both these drivers, as well as the concept, purpose and importance of financial and tax literacy, in order to determine the relevance of those findings with regard to whether financial and tax literacy could increase either one or both of the drivers.

3.1. THE CONCEPT, PURPOSE AND IMPORTANCE OF FINANCIAL INDEPENDENCE DURING RETIREMENT

When considering the concept of financial independence, it is also important to consider the components that will affect it. As previously stated (refer to 2.2.1.), financial independence is having sufficient personal wealth to live and be able to afford basic necessities without having to work actively. It is therefore important to note that unless you have sufficient personal wealth to live, i.e. to take care of your basic needs, you will not be financially independent after retirement. Income or sufficient available funds to cover your cost of living is therefore the first and primary component that will enable a person to be financially independent. In essence, retirement means that the retired person will no longer be actively working and will therefore not receive a regular income. It should therefore be clear that a person who is not financially independent during retirement will face poverty and/or be dependent on funds or income provided by third parties (i.e. family, friends or the government) (refer to 1.5).

Savings are inter alia referred to as deferred consumption (see to 2.2.1), which implies previously received income that could be used at a later stage (i.e. during retirement). Therefore, the more savings are available, the more consumption will be possible, or the higher the level of financial independence will be. It can therefore be concluded that a person's level of financial independence during retirement will first and foremost depend on the 'income' he/she earns today.

2.3.1. Income

Income has been defined as, for example, *'the consumption and savings opportunity gained by an entity within a specified timeframe, which is generally expressed in monetary terms'* (*Barr, 2004:121). However, for households and individuals, 'income is the sum of all the wages, salaries, profits, interest payments, rents, and other forms of earnings received ... in a given period of time'* (*K. & Fair, R:2007:54).* In the field of public economics, income could also be defined as *'the accumulation of both monetary and non-monetary consumption ability, with the former (monetary) being used as a proxy for total income' (Barr, 2004:121).*

One can conclude that in the most basic sense income is the total funds a person receives (through different channels) in a given period of time. It is interesting to note that it is also defined as 'the consumption and savings opportunity gained …' and the 'accumulation of … consumption ability' (Barr, 2004:121), which imply that income results either in consumption or in savings. However, the last-mentioned definition can only become true through saving. This confirms the earlier conclusion that a person's level of financial independence during retirement will depend on the 'income' earned today. Savings are therefore reliant on income, which makes income the primary component of savings, and therefore also of financial independence. An important aspect to note is that since income is linked to a time period, the implication is that savings will be dependent on the same time frame. Furthermore, since income is referred to as 'savings opportunity gained' (see definition above), it follows that if opportunities (income) for saving are not used, fewer opportunities will arise as the time period during which a person can save (to which income is linked) will decrease. Another important aspect to consider is the ability to increase income within the specified time frame, which could increase the ability to save and therefore the level of financial independence.

In a practical sense, a person's ability to create or increase income will depend on, among other things, his or her skills level. According to Struwig and Plaatjies (2015:5), the income earned by individuals is influenced by the availability of education and the standard, quality and content of the education they received. However, even though education could most certainly influence a person's ability to create income, other factors should also be taken into consideration. A more accurate statement would be that the income of individuals is influenced by the standard, quality and content of the income-generating skills and/or the resources available to them.

When considering the ability of individuals to save (which is directly linked to income, as mentioned above) it is crucial to take note of the three groups into which Finscope (2015: 2, 13 and 14) divided 32 469 482 South Africans, namely adequately served; moderately served; and thinly served. This is based on inter alia the range of products held by them to enable them to save. In the group described as thinly served, 17% earned more than R3 000 per month and 33% had completed matric or some form of tertiary education, whereas in the group described as moderately served, 51% earned less than R3 000 per month and 80% had completed matric or had some high school education. Lastly, 46% of the adequately served group earned less than R8 000 per month and almost 60% only had matric or a lower level of education. A further interesting fact is that in the case of the moderately and adequately served groups, 27% and 52% respectively had their own businesses.

An analysis of the above statistics clearly shows that although income provides the ability and opportunity to save, it does not mean that it will result in saving. Moreover, although education can potentially enable a person to generate an income, it is evident that having income-generating skills and resources (i.e. an own business or investments) also plays a considerable role. Lastly, when considering the saving ability of the different groups, it is clear that other factors besides income and education also influence people's ability and willingness to save. In fact, there is no indication that education alone increases people's ability to save, which is illustrated by the finding that 33% of the thinly served group had completed matric or higher education, while 60% of adequately served group had matric or a lower level of education. An interesting point is that 52% of the adequately served group had their own businesses (Finscope, 2015:12,13 and 14). This is either an indication that they possess sufficient income or skills/abilities (which include willingness), or both, to enable them to save.

With regard to the ability to generate income, it is important to note that income can be generated through different channels and from different sources, some of which will require active involvement. These sources would typically be employment or other work-related activities. This means that unless a person is actively involved in such activities, no income will be generated from them. However, these are not the only sources that could generate income and one should also consider so-called 'passive income'. Passive income, in essence, refers to income that is generated without actively working (Finscope, 2015:18), which would typically include rental income, interest income and dividend income (Finscope, 2015:20). It is, however, important to realise that these sources are initially created with income (from whichever source) that was not previously used for consumption (i.e. savings). It is therefore possible for individuals to use previously saved income to create an income that will set them free from being required to work actively. Such sources of income could create financial independence. To conclude, income will always need a source from which it can be generated. The availability, standard, quality and content of these sources will affect people's ability to save, and ultimately their financial independence. The next component, which is expenses, will be considered in the following section.

2.3.2. <u>Current consumption (expenses)</u>

Although income will always need a source, expenses will occur even if there is no source from which income can be generated. Like income, the concept expense is relative – not so much in respect of its definition, but mostly when it relates to the amount of income used for expenses (consumption). Expense is defined as an outflow of money to another person or group to pay for an item or service, or for a category of costs (www.oxforddictionaries.com), or as *'... decreases in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrences of liabilities that result in decreases in equity, other than those relating to distributions to equity participants'* (IFRS Framework, F.70).

This basically implies that an expense is money/funds used for consumption. It therefore decreases a person's ability to save. It goes without saying that the bigger the expense component is, the smaller the possible savings component will be. Even when no saving is required, an expense component that is greater than the income component will result in either the consumption of third-party income, or debt. Income that is not consumed can be referred to as 'accumulated/deferred consumption ability' (i.e. savings). The opposite is true for consumption that is greater than income. If this results in debt it would be accurate to say that debt is accumulated consumption, which needs to be funded from future income (exactly the opposite of savings). Therefore, if the expense component is decreased, not only the ability to save, but also financial independence can be increased.

Like income, expenses can be subdivided into subcategories, which could be further subdivided into necessities (needs) and luxuries (wants). The nature of expenses will depend on the consumer and this study will therefore not discuss these categories in more detail. However, the so-called 'tax expense' will be examined. Furthermore, in order to obtain a better understanding of South Africans' spending culture, the study will look at how they spend their income.

In 2014, living expenses (consumption) accounted for 65% of the income of South Africans, while 15% was used for paying off debts. In 2015, 68% was spent on living expenses (consumption) and 12% on debt repayments (Old Mutual Savings Monitor, 10th ed., 2015:12). This indicates that currently an alarming 80% of South Africans' income is consumed. What is even more worrying is the fact that, according to Finscope (2015), 26% of all people who have taken unsecured loans did so to buy food; 12% to pay for transport; 10% to pay bills; and 10% to buy clothes. These loans increased by 6% from 2014 to 2015. This illustrates what was previously referred to as accumulated consumption. Another rather worrying fact is that only 53% of those South Africans earned less than R8 000 per month, with the remaining 47% earning more than R8 000 per month. This again indicates that sufficient income is not the only driver of people's ability to save. Finscope (2015) conducted a survey to determine people's opinions of credit cards and the results were as follows: 27% of the respondents said: '*Credit cards are the greatest thing, you can buy things you can't afford'* and 24% said: *'If you really want something, you can buy it on credit and don't wait'.* Therefore 52% of the respondents viewed credit cards as a vehicle for funding consumption. As previously stated, it is not the goal of this study to analyse the expenses. However, this is a fundamental issue that individuals will need to address if they wish to increase their ability to save in an attempt to become financially independent.

2.3.2.1. Tax expense

As mentioned above, the nature of expenses depend on the consumer. However, one expense that is relative to the amount that is spent, but more constant as almost every person incurs this expense and it is not necessarily linked to consumption, is the so-called 'tax expense'.

When considering the fact that reduced expenses could increase a person's ability to save, one should not consider consumption expenses only. If the tax expense component can somehow be reduced, this could also increase people's ability to save and consequently their level of financial independence. Moreover, tax is not necessarily linked to consumption, and can therefore be decreased without reducing consumption. This could be achieved in different ways, which could include efficient and effective tax planning, avoiding double taxation and utilising tax incentives.

Tax is, however, somewhat more complex than other general expenses. Any attempt to reduce tax will require good knowledge and a thorough understanding of the tax system. The taxes levied differ from one person to the next. Taxes are payable at different levels, on different components of income and on different activities. Due to the complexity and diversity of the different taxes that are levied, it is common to find that people generally lack knowledge and a thorough understanding of how taxes are levied and calculated. Coetzee and Oberholzer (2009:13) found that training offices in public practice (in South Africa) indicated that 62% of first-year trainee accountants have negligible to no knowledge of general tax administration, despite the fact that they had all obtained a university qualification in accounting; 70% of trainee accountants have negligible to no knowledge of tax planning; and 54% of trainee accountants have negligible to no knowledge of employment companies. In another study (Meyers, 2012:26) it was established that 59.7% of South Africans do not believe that tax can be avoided through careful planning. In the same study, only 40.1% of the South African respondents knew that contributions to a pension fund are tax deductible and only 33.8% realised that contributions to a retirement annuity fund are tax deductible. When the same respondents were asked whether they felt that they needed to know more about income tax, 68.4% agreed (Myers, 2012:28). It is therefore safe to assume that South Africans in general lack the necessary knowledge and understanding of taxes. The result is that people make financial decisions without considering their tax effect. Therefore South Africans potentially miss out on opportunities to legally decrease their tax expense component, and consequently also opportunities to increase their ability to save and their financial independence.

Although taxes can be saved in different areas, this study will focus primarily on taxes (e.g. income tax) that directly influence individuals' ability to save, and more specifically their ability to save towards retirement. When considering these taxes, one needs to consider contributions to retirement or other funds, which will qualify for deductions, tax credits and income exemptions.

With regard to investments, considerations mostly revolve around the projected growth and the risks involved, and rightly so. However, something that is generally not considered, or considered only to a lesser extent, is how the investment will be taxed when paid out, and whether the contributions will qualify for a tax deduction. The advantages of utilising the tax deductions that are available will be illustrated by way of examples and calculations later on in the study. Here a simple example will suffice: If a person invests in a fund that achieves a growth rate of 15% per annum, but does not qualify for any tax benefits, it could potentially end up showing only a 12.5–13% growth after tax, whereas a fund that qualifies for tax exemptions would benefit from the total growth. Therefore a fund that offers a lower growth rate, which is normally coupled with lower risk, but for which contributions are tax deductible or the returns are exempt, could give the same or even a better return. Tax benefits provided by the Act mostly apply to contributions to funds that qualify for a deduction against taxable income and income and capital funds that qualify for an exemption when paid out. These two vehicles accrue their benefits in different ways that are coupled with related advantages and disadvantages. It is important to understand that these tax incentives are not an income- generating activity, but rather serve to reduce expenses and will be applicable when the savings that are generated are invested.

2.3.2.2. Tax benefits offered on contributions to pension, provident and retirement annuity funds

In his 2013 budget speech, the Minister of Finance proposed that tax deductions applicable to employee contributions to pension, retirement annuity and the newly included provident funds should be harmonised and increased to 27.5% (National Treasury, 2013b: 18-19). On 1 March 2016, the proposal was implemented and taxpayers are now allowed a deduction of 27.5% of the greater of taxable income or remuneration, up to a cap of R350 000, for contributions to all retirement funds (including provident funds) (Income Tax Act No. 58 of 1962).

Consumers can choose from a variety of funds that qualify for the tax deduction. The focus of this study is, however, not the different funds, but rather the tax benefits that they offer. An important fact to consider when dealing with these tax benefits is the fact that they come in the form of deductions, and not in the form of grants or some other income benefit. Therefore the principle behind the tax deduction is: the more a person invests in one of these funds, the greater the tax deduction (benefit) will be. In other words, the more income is distributed to saving in these funds, the less taxable income will remain, and when less tax has to be paid the taxpayer's ability to save increases. The tax benefit derived from investing in these funds will therefore not result in more income being available for current consumption. In fact it will decrease the income that is available for current consumption, but will increase savings (accumulated/deferred consumption ability) which is aimed at increasing the level of financial independence during retirement.

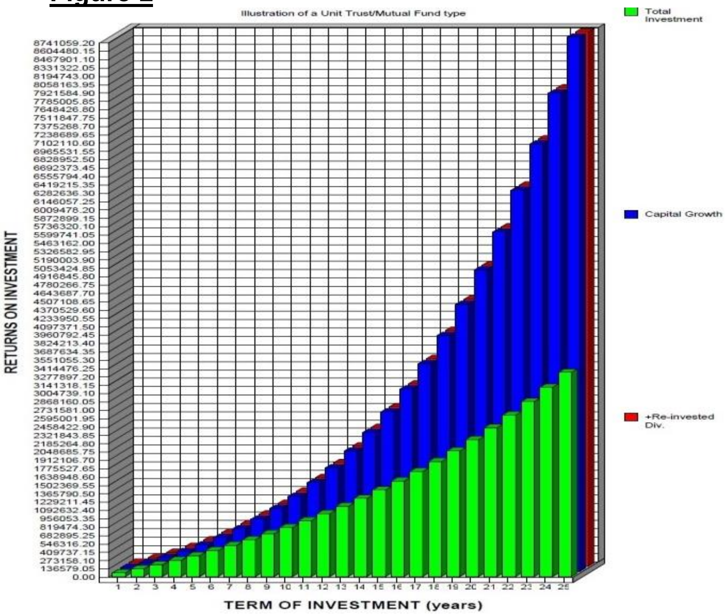
As is generally the case, the way a concept works has to be understood before it can be implemented in practice. However, as previously stated, in 2009 only 40.1% of South Africans knew that money paid into a pension fund is tax deductible, and only 33.8% (refer to 2.3.2.1) realised that money paid into a retirement annuity fund is tax deductible. One cannot wonder, therefore, about how effective these tax benefits actually are. In a more recent study conducted by Moolman (2015), 80% of the participants indicated that, in the light of the increase in the tax deduction available to them, they would be willing to increase their retirement savings. However, of this 80%, 87.5% indicated high the cost of living as the main deterrent to saving more towards retirement. This quantifies the previous statement that South Africans do not understand how these benefits work. The question that now has to be answered is: How does the tax deduction then benefit individuals?

The principle of income tax can be expressed at a very high level as: Income – deductions = taxable income x tax rate = tax. Therefore the higher the deduction component is, the less the taxable income will be, which would imply that less tax will be payable. This principle could be further explained as follow: Assuming that an individual falls within the 41% tax bracket (rate), this will mean that for every R1 of taxable income received, he will receive only R0.59 (1 – 0.41%) of income earned for consumption or saving. Therefore, to be able to save R1, a person will need to earn R1.69 (R1.69 – 0.41% = R1). Therefore, if an individual is not liable for the 41% tax, he would be able to save R1.69 for every R1 he would have been able to save if he had been liable for the 41% tax. The benefit of the tax deduction for contributions to retirement funds is based on this principle.

In essence, the deduction for contributions to retirement funds implies that an individual can invest pre-tax money because of the deduction that is allowed. To illustrate this principle, let us assume that an individual earns R600 000 taxable income per annum. Without any deductions this person would fall within the 39% tax bracket (2017 tax period). The tax payable (without any deductions) on this amount will be R167 457, which would leave him with R432 543 available for consumption and saving. If we further assume that the individual utilises the full 27.5% deduction, he would be able to deduct R165 000 from his taxable income. The net effect will be as follow: R600 000 – R165 000 = R435 000 taxable income. The tax payable would then be R106 560, which would leave the taxpayer with R328 440 available for further saving and consumption. The net effect is that the taxpayer invested R165 000 and had R328 440 available for further investment or consumption, which adds up to a total of R493 440. This is R60 897 more than would have been available without the deduction. What is important to note is that if the individual had chosen to invest the full 27.5%, he would have had only R328 440 available for current consumption, instead of the R432 543 he would have had if he had not invested the full amount. This is, however, where the first issue comes in: an individual who is not willing to reduce spending (consumption) will not be able to make use of the tax deductions.

To further illustrate the long-term benefit of the R60 897 tax saving that is invested, the study will assume that the investment will grow at rate of 8% per annum (market related for funds of this type), and that it is invested for 25 years with an investment escalation of 6% per annum (linked to inflation). This will result in a total investment of R3 341 084 over the 25 years, with a capital growth of R8 741 060 (refer to Figure 1). To put this into perspective, it basically means that the tax saving (expense reduction) will be worth R8 741 060 at the end of the 25-year investment period.

Figure 1



What should however be taken into account, especially when comparing retirement funds with tax-free savings accounts and so-called long-term insurance cash backs (which will be dealt with later), is the fact that retirement funds are taxed as lump sums when paid out. Furthermore, an important fact about these funds is that they are regulated by the Pension Funds Act No. 24 of 1956, which stipulates that when these funds are paid out, only one third of the total amount may be taken as a lump sum and the rest should be reinvested in a guaranteed and/or living annuity. These annuities are based on the principle that the remaining two thirds of the fund will provide a person with a yearly or monthly annuity for either a predetermined period, or a lifetime. There are different types of annuities, each with its own advantages and disadvantages. This study will however not investigate them as the focus here is on the tax implications.

To determine the tax liability on incomes from funds and annuities, they should be split into two parts, the first of which is the amount taken as a lump sum on retirement (one third of the amount accumulated in the fund). Currently the first R500 000 is tax free (in a lifetime). Thereafter the tax rate starts at 18% and moves up to a maximum of 36%. The second part (two thirds) will then be paid out as a yearly/monthly annuity, which will be taxed according to the individuals' applicable income tax bracket. Therefore, when considering the example stated above, the tax implications will be as follows: Currently, on the first part

(R8 741 060 x 1/3 = R2 913 687) the tax component will be R801 427. On the second part it will be very difficult to project the tax component as there are many factors to consider (the type of annuity, other income, etc.). If one assumes that people with the kind of investment mentioned above are likely to be able to sustain their standard of living, the remaining part could be taxed at an effective tax rate of between 20% and 30% (based on a person currently earning an annual taxable income of between R400 000 and R800 000). Therefore, in a lifetime or over a predetermined period, it is likely that tax of between R1 165 475 and R1 748 212 could be payable. The net effect, based on the 30% effective tax rate assumption, will still be that the value of the tax saving (expense reduction) over 25 years will be worth R6 191 421 after tax.

2.3.2.3. Tax benefits applicable to tax-free savings accounts

On 1 March 2015 the so-called tax-free savings account was introduced and included in the Income Tax Act No. 58 of 1962 in terms of section 12T. A tax-free savings account serves as a vehicle for South African residents to make contributions to savings accounts or funds from their post-tax salaries. These contributions will, however, be limited to R30 000 per year and R500 000 over a lifetime. The benefit provided by the tax-free savings account is that all the returns, income and capital of nature will be exempt from income tax (Kensley, 2015:2).

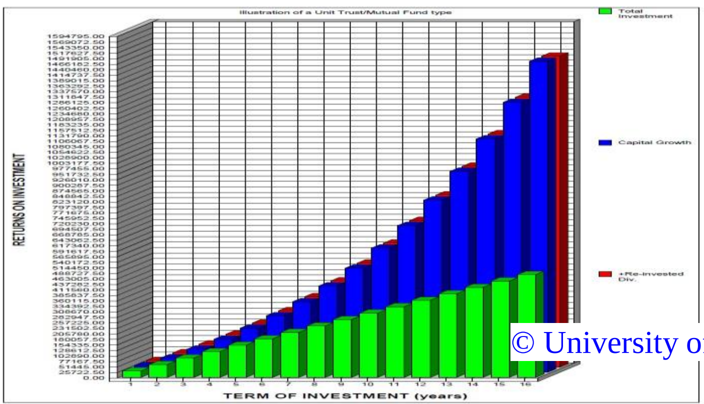
Viewed from a tax perspective, probably one of the main differences between tax-free savings accounts and retirement funds is that withdrawals made from a tax-free savings account will be non-taxable, whereas those made from a retirement fund (as explained above) will be fully taxable. However, unlike contributions to retirement funds, contributions to a tax-free savings account will not be tax deductible. Therefore, although the withdrawals from a tax-free savings account will be non-taxable, it is important to note that for every R1 invested in a tax-free savings account, an individual would have been able to invest R1 plus the tax component in a retirement fund. As explained in the previous section, this will mean that a person who falls within the 41% tax bracket will be able to contribute R1.69 to a pension fund for every R1 invested in a tax-free savings account. This benefit will decrease as the applicable tax rate decreases. For instance, a person who falls in the 18% tax bracket will be able to contribute only R1,22 for every R1 after tax. A more detailed comparison will be made later on in the study.

The important consideration for this section is that the tax benefit that applies to a tax-free savings account comes in the form of an income tax exemption and not a tax deduction. The concept of a tax-free savings account therefore differs somewhat from retirement funds. Retirement funds aim to increase investments (savings) and tax the growth in investment, whereas tax-free savings accounts aim to tax current income and not the growth therein. The tax expenses reduction will therefore only come into effect when the money is withdrawn. Consequently, the greater the growth of the investment, the greater the tax benefit will be. When considering the concept of compounding, the implication is therefore that tax-free savings accounts will maximise their tax benefit when used as a long-term investment.

Another important aspect that should be taken into consideration when dealing with tax-free savings accounts is the contribution limitations. The current limitations of R30 000 per year and R500 000 in a lifetime are subject to penalties if exceeded. Again several funds are available from a variety of services providers, but they will not be discussed here. However, as with retirement funds, when investing in these funds the tax benefit will not result in having more income available for current consumption as it will decrease the income available for current consumption and increase savings (accumulated/deferred consumption ability) and will thus increase financial independence during retirement.

To illustrate the principle of a tax-free savings account, it will be assumed for the purpose of this study that an investment of R2 500 per month (R30 000 per year) will be contributed for 200 months (by which time the lifetime limit of R500 000) will have been reached, and will then be kept in the fund for another 100 months (25 years in total). Furthermore it will be assumed that an average growth rate of 12% (market related) is achieved.

Figure 2

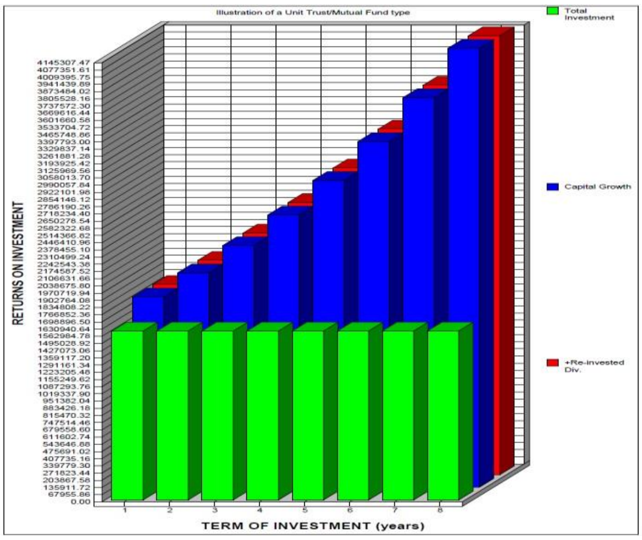


This will then result in a total investment of R500 000 and a capital growth of R1 594 795 for the first 200 months (refer to

Figure 2). If it is invested for a further 100 months, the investment will grow to R4 313 624 (refer to Figure 3).

To be able to illustrate and calculate the value of the tax benefit (saving), some assumptions will have to be made. It will therefore be assumed that the tax-free savings account in which the money was invested is similar to a unit trust, which will imply that the growth will be of a capital nature. Furthermore, interest or dividend income will not be taken into account and it will be assumed that the account holder falls in the 41% tax bracket, which will mean that the effective tax rate for capital gains purposes will be 16.4%. The net effect based on the effective tax rate assumption will be that after 25 years the value of the tax saving (expense reduction) will be R625 435, which is considerably more than the initial investment (R500 000).

Figure 3



2.3.2.4. Tax benefits available to members of other retirement investment schemes

Retirement investment schemes vary with regard to their form and how they are managed. These schemes are, however, mostly linked to some kind of long-term insurance, such as life, disability and severe illness insurance. The rationale behind this is that pay-outs from these funds are, subject to certain requirements, exempt from income tax in terms of section 10(1)(gG), (gH) and (gI) of the Act. Consequently these schemes are mostly based on cash-back or surrender-value payments during retirement, which will also be exempt from tax for income tax purposes.

Due to the diverse nature of these schemes, no attempt will be made in this study to illustrate the value of the tax savings offered by them. Such a scheme could however form a very useful part of a retirement plan. As stated above, the pay-outs from these funds will be exempt for income tax purposes and contributions are not limited, as in the case of tax-free savings accounts.

2.3.3. <u>Savings (accumulated/deferred consumption ability)</u>

According to Wikipedia, savings are income not spent, or deferred consumption. This implies that it will be possible to save only if some income is still available after expenditure has been deducted. As explained earlier and illustrated above, savings can also be increased by reducing expenses. However, the mere availability of an opportunity to save does not necessarily imply that saving will occur. As Gerald Mwandiambira (Chief Strategist of the South African Savings Institute) says in his blog (2015), *'before you embark on "savings" you may need to "save"'*.

The Old Mutual Savings Monitor (Le Roux, 2015:19) stipulates that only two things drive savings: the ability to save and willingness to save. Savings can also be referred to as deferred consumption. Deferred consumption therefore implies that you previously received an income that was such that you were able to save some of it for consumption at a later stage (i.e. during retirement). Therefore, the more money a person has available, the more consumption will be possible, or the higher the level of financial independence will be during retirement. Notwithstanding the stated by Le Roux in the Old Mutual Savings Monitor, savings are driven by two factors: the ability to save and willingness to save. However, one should also consider the drivers of these factors.

2.3.3.1. The ability to save

As mentioned above, the ability to save will be subject to the income that is available to save. However, savings are not necessarily directly proportional to income earned or received. Income earned is only the first step to saving, as in order to save people will need to enable themselves to save by ensuring that part of their income will be available for saving once expenses have been deducted. The ability to save could also be increased by obtaining sufficient knowledge of the different formal vehicles that are available for saving, since by investing in those vehicles they can increase their savings without.

It is therefore possible to increase savings by simply making use of the available tax reduction and effectively planning your financial affairs. Ignorance about tax matters and tax incentives could potentially hamper a person's ability to save, while knowledge could potentially increase people's willingness to save.

According to FinScope (2015:8), 64% of adult South Africans do not save, 28% have never thought about saving and 13% feel that they cannot afford to save. Of the 36% of respondents that do save, 13% make use of informal methods of savings and save at home. These statistics clearly indicate that South Africans generally do not possess enough knowledge about saving and that potentially 41% of the non-savers could, by informing themselves about tax, actually afford to start saving. Furthermore, of the 36% who were already saving, at least 13% could increase their savings if informed and guided to invest in more profitable and tax-beneficial saving vehicles.

The ability to save will also be driven by a willingness to save, and vice versa. A person who is willing to save will seek more information, which will in turn increase his or her ability to save. However, for this to happen, the concept and importance of saving must first be understood, which might spark a desire and willingness or motive to save. It has been said that a sure way to gain financial security or independence in life is not to have enough savings, but to have enough ability (Old Mutual Savings Monitor; Le Roux, 2015: 25).

2.3.3.2. Willingness to save

A willingness to save can only be created if there is something that drives and motivates the decision to save. Besides the fact that some South Africans simply cannot afford to save, many do have sufficient resources to save, but choose not to do so, or rather choose to spend their available funds on luxuries and other consumption-driven items. When considering inflation and the time value of money, it is generally found that South Africans have no idea of how much they will need to save to be able to maintain a good standard of living during retirement. As stated earlier, only 6% of South Africans can currently maintain their standard of living during retirement (Lamprecht: 2015:1).

According to the Old Mutual Retirement Calculator (https://www.oldmutual.co.za/personal/retirement-planning/retirement-calculator), a person who is currently 30 years of age, earns R3 000 per month and wishes to retire at the age of 60, will need R4 300 000 in savings to maintain his/her standard of living during retirement. A person in the same scenario who currently earns R35 000 per month will need R48 113 810. Given these figures, it is not surprising that many people only discover three years into their retirement that they cannot really afford the luxuries they had grown accustomed to during the previous 25 to 35 years. It is clear that South Africans should be made aware of the vast amounts that they will need to maintain their standard of living after retirement, to make them realise the importance of saving and to create a willingness to save.

2.3.3.3. Formal saving vehicles

This study is not aimed at concluding on which saving vehicles are the most profitable or beneficial, but rather to establish whether these vehicles are beneficial and what benefits they offer. In order to achieve this, different options will be examined and analysed. The findings should however not be seen as financial advice, but rather as useful information.

The focus will be on pension and provident funds in general, tax-free savings accounts and ordinary unit trusts, and on the tax implications of each of these forms of saving. Even though it is unlikely that the growth rates of the different funds will be same, the same growth rates, amounts and time periods will be assumed to ensure a fair and comparable outcome.

Due to the fact that deposits into a tax-free savings account are limited to R30 000 annually and R500 000 over a lifetime, the example will assume a monthly contribution of R2 500 for 200 months. Furthermore the study will assume a marginal tax rate of 31% (taxable income of between R293 600 and R406 400 per year – 2017 year of assessment) and therefore an effective tax rate of between 16.4% and 20.4%. An average effective tax rate of 18.4% and an average effective capital gains tax rate of 15% will be used (realistic, based on the other assumptions). As explained earlier, the pension fund contributions will be tax deductible and will therefore enable a person to contribute the tax savings portion as well. For a person who pays the 31% marginal tax rate, this will mean that for every R1 after tax, he/she will be able to contribute R1.45 before tax, which will amount to a contribution of R3 625 per month.

Tax-free savings vehicle (R2 500 per month x 200 months)

Expected value @ 12% growth:	R1 594 795
Tax payable on the above amount:	R0.00
After-tax proceeds	**R1 594 795**

Retirement, pension, provident fund vehicle (R3 625 per month x 200 months)

Expected value @ 12% growth:	R2 312 452
One third lump sum (R2 312 452 x 33.33%):	R770 810
Tax payable of the above amount:	(R 209,992)
(Assuming that the R500 000 lifetime benefit has already been used)	
After-tax proceeds	**R560 818**
Two thirds compulsory annuity:	R1 541 642
Tax on the above amount (effective tax rate of 18.4%)	(R283 662)
After-tax proceeds	**R1 257 980**
Total after-tax proceeds	**R1 818 798**

Normal unit trust (R2 500 per month x 200 months)

Expected value @ 12% growth:	R1 594 795
Tax payable on the above amount (effective CGT rate 15%):	(R 239,219)
After-tax proceeds	**R1 355 576**

Therefore, based on the illustration above, a tax-free savings vehicle and pension fund vehicle will be worth R239 219 and R463 222 more respectively than an ordinary unit trust investment with the same amount of funds invested and based on the same time frame. Among the other considerations that should be taken into account is the fact that two thirds of a pension fund should be reinvested in either a guaranteed or a living annuity, or in both, which means that the funds will not be immediately accessible, but will be paid out as a yearly or monthly annuity. However, since these are personal and subjective decisions that do not add value to the focus of this study, they will not be discussed.

When considering the value of investing in formal vehicles that will benefit from the principle of compounding, it is important to note that this benefit, and thus also the tax benefit, will increase as the time frame increases. The principle of compounding therefore emphasises that it is important to save in these formal vehicles and to start investing in them as soon as possible. To illustrate the principle of compounding, three different scenarios will be sketched.

In the first scenario, a married couple will invest R5 000 (R2 500 each) per month in a unit trust from the age of 25, up until the age of 60 (35 years). The unit trust will achieve an average growth rate of 12% per annum. In 35 years this will result in a total investment of R2 100 000 and a total investment value R32 476 345 (refer to Figure 4).

In the second scenario, a married couple will invest R12 500 (R6 250 each – two and a half times more than the first couple) per month in a unit trust from the age of 35, up until the age of 60 (25 years). The unit trust will achieve an average growth rate of 12% per annum. In 25 years this will result in a total investment of R3 750 000 and a total investment value of R23 720 439 (refer to Figure 5).

The third and final scenario reflects what 13% of South Africans are currently doing, which is saving at home and in informal vehicles. Many of these South Africans do not have bank accounts, but for purpose of this example it will be assumed that a couple saves R12 500 (R6 250 each) in a bank account that bears interest at 4% per annum, from the age of 25 to the age of 60 (35 years). This will result in a total investment of R5 250 000 and a total investment value of R11 459 709 (refer to Figure 6).

Figure 4

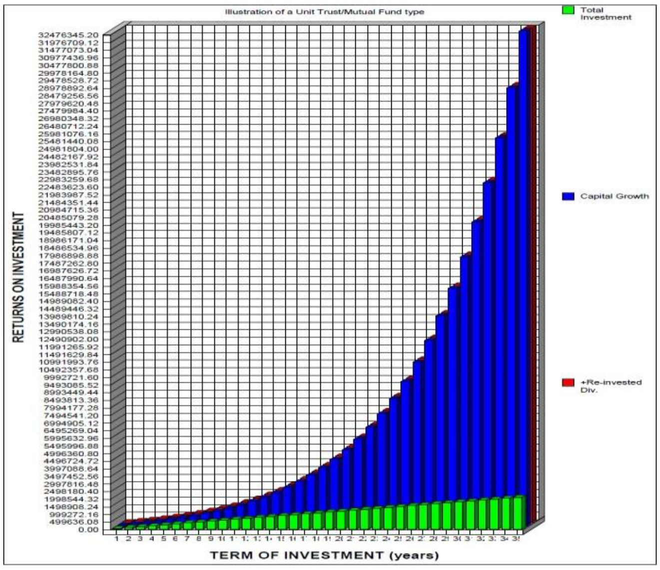


Figure 5

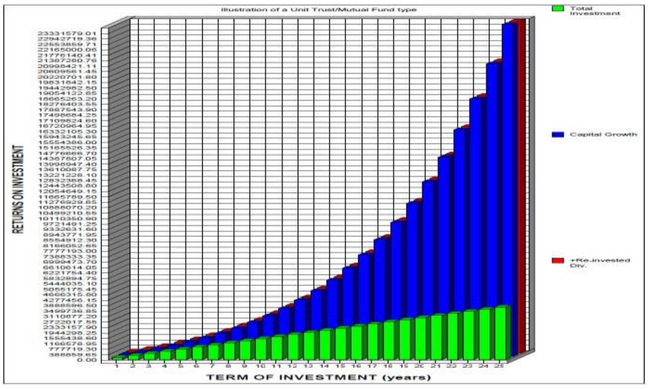
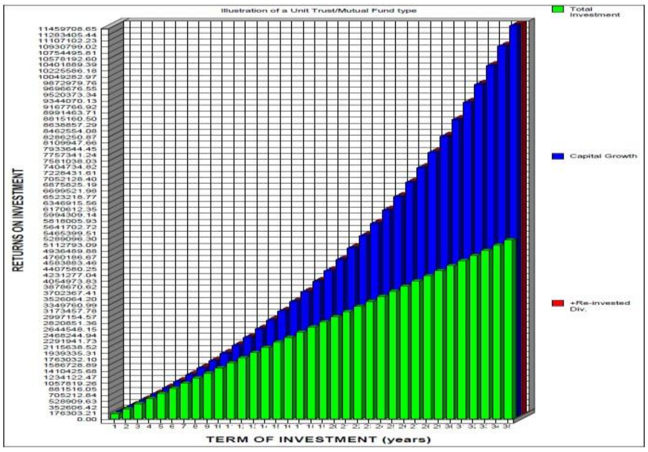


Figure 6



When we look at the above examples, it is surprising to note that even though the first couple invested a total amount of only R2 100 000, as opposed to the second and third couples who invested R3 750 000 and R5 250 000 respectively, it is projected that they will eventually have a total investment value of R32 476 345, which is R8 755 906 more than the second couple and R21 016 636 more than the third. This substantiates the earlier statement that a person's ability to save can be increased by knowledge and that income is only the starting point, even though savings will not be possible without it. As previously stated, income and the ability to save are linked to a time period, and when this time frame decreases the ability to save will also decrease retrospectively.

Based on the literature review, it can therefore be concluded that by utilising the benefits provided by tax incentives and formal saving vehicles, South Africans could substantially increase their level of financial independence during retirement. However, for this to take place they should inform themselves about the available incentives or make use of the advisory services of well-informed professionals.

CHAPTER 3:
RESEARCH DESIGN AND METHODS

In the previous chapter, current literature was scrutinised and analysed in order to obtain knowledge and understanding of the relevant tax and financial concepts. Findings were tested for accuracy and correctness against each other and against other sources that deal with similar concepts. In Chapter 2 it was concluded that by utilising the benefits provided by tax incentives and formal savings, South Africans could increase their level of financial independence during retirement. Chapter 3 describes the sampling and survey methods that were applied and also includes a discussion of the data-collection instrument and data analysis method used to primarily determine whether tax and financial literacy could indeed improve South Africans' level of financial independence during their retirement years.

3.1 RESEARCH PARADIGM

This study incorporates constructivism (interpretivism) as a research paradigm with the primarily purpose of determining whether tax and financial literacy could improve South Africans' the level of financial independence during retirement. This can be described as constructivist or interpretivist research approach (University of Pretoria, 2014:2).

3.2. DESCRIPTION OF SURVEY STRATEGY AND BROAD RESEARCH DESIGN

The survey strategy applied in this study was a structured questionnaire supported by Survey Monkey (https://www.surveymonkey.com). Survey research is defined as '… acquiring information about one or more groups of people – perhaps about their characteristics, attitudes, or previous experiences – by asking them questions and tabulating their answers. The ultimate goal is to learn about a large population by surveying a sample of that population'. (Leedy & Ormrod, 2010:187).

An online questionnaire was chosen as the strategy for this study as it ensures a wide variety of easily accessible participants. The online process is also simple and allows participants to complete the questionnaire in their own time whenever it is convenient for them. This therefore improves the participation rate and also the degree of care and thought that goes into answering the questions. The first questionnaire was designed specifically to allow the researcher to gain insight into, among other things, participants' levels of financial and tax literacy. The second questionnaire that provided the participants with more insight and background with regard to tax-beneficial investment funds in order to determine whether they might act differently if they were better informed on tax and financial concepts and principles. This study was based on the following research objectives:

- To determine the financial and tax literacy of South Africans, regarding financial independence during retirement.
- To determine the extent to which South Africans are willing to save, and whether their ability and willingness to save will increase once they have gained gain a better understanding of tax and financial concepts and principles.
- To conclude whether tax and financial literacy can increase financial independence during retirement.

Since primary data was collected and analysed, this study can be classified as an empirical study. Primary data can be defined as data that is collected for a specific study or project (Saunders, M., Lewis, P. & Thornhill, A., 2012:678).

The data for this study was collected by means of a structured online questionnaire, therefore it can be classified as survey research (as explained previously). The data provided by the survey generated non-numerical and numerical information, which indicates that quantitative and qualitative data were collected. The quantitative data provided statistics that made it possible to measure the results. The qualitative data gave an indication of how South Africans are likely to react to different scenarios and sketched a picture of their thought patterns and actions. A further approach, namely correlation research, was used as the study examined the extent to which differences in one characteristic or variable are related to differences in one or more other characteristics or variables (Leedy & Ormrod, 2010:183).

This study was aimed at gaining an understanding of the behaviour of South Africans, as well as determining whether the data can provide information that could potentially offer solutions to change the poor saving habits of South Africans. This study therefore contains both a descriptive and an informative component.

3.3. SAMPLING

Whether observing, interviewing, experiencing, or pursuing some combination of strategies, you cannot be everywhere at once. Instead you develop certain perspectives by engaging certain people rather than others (Schram, 2003:97). By doing so, one would make use of a technique called sampling as you reduce the amount of data you need to collect by considering only the data obtained from a subgroup, rather than from all the possible cases (Saunders *et al.,* 2012:258).

3.3.1. <u>Target population and entities from whom data was collected</u>

The study was aimed at South Africans between the ages of 18 and 40 years as this is the group that is most likely to benefit from this study. Moreover, the study focused on literate South Africans with higher education who earned some sort of income.

3.3.2. <u>Unit of analysis</u>

The units of analysis were South Africans with higher education who are literate and receive some form of income.

3.3.3. <u>Method used to select participants</u>

The participants were selected by using both the stratified random and criterion sampling methods.

Stratified random sampling is a modification of random sampling in which the population is divided into two or more relevant groups, based on one or more attributes (Saunders *et* *al.,* 2012:228). This sampling method was considered to be appropriate since the aim of the study was to obtain information with regard to a specific group (i.e. literate 18- to 40-year- olds who earned some form of income).

Criterion sampling involves selecting cases that meet some important predetermine criterion (Cohen & Crabtree, 2006). As this study focused on literate South Africans who received some form of monthly income and were between the ages of 18 to 40, the specific criteria for the sample were pre-set.

Both the abovementioned methods are classified as purposive sampling. Purposive sampling is a procedure during which the researcher uses his/her own judgement to select cases that make up the sample (Saunders *et al.,* 2012:678). The limitation of this type of sampling is that it is too small to be considered statistically representative of the total population.

3.3.4. Sampling size

A sample size of 35 was used. Even though this is a small sample size when compared to the total South African workforce, the researcher was confident that this selection would provide a reasonable representation of the characteristics of the selected participant group. Moreover, due to the fact that the participants were all literate and from different backgrounds and industries, the researcher believes that the degree of accuracy required for this study was met. This study did not determine the total population of the relevant participants.

3.4. DATA COLLECTION

3.4.1. Survey method

The data required for this study was obtained by using the survey method, which is a practical method for obtaining the relevant information in a manner that does not require too much time and effort from the participants and therefore increases the probability of participation and accuracy. As stated earlier, the data that was collected is of a primary, qualitative and quantitative nature and was obtained by means of an online questionnaire that was sent to 35 participants. The primary participants were selected from the researcher's network, which was extended to the networks of the selected primary participants.

The questionnaire was sent out via email on 24 October 2016 and participants were given 10 weeks to respond. The email explained the purpose of the questionnaire and how the participants could assist with the study. It also explained that no knowledge of taxation or other financial concepts was necessary in order to be able to answer the questions, and that there were no right or wrong answers. As stated in the objectives, part of the purpose of the study was to determine how tax and financially literate South Africans are. The participants were put at ease and were assured that their answers would be treated confidentially and that no personal information was required. They were also informed that, due to the nature of the online software that was used, the researcher would not be able to link the answers to any specific person.

3.4.2. <u>Design of questionnaire</u>

The questionnaires are included in Appendix A.

The questionnaire consisted of two separate parts that contained 10 and 7 questions respectively. Both sets of questions were designed to provide quantitative and qualitative data. The participants were required to complete the first questionnaire before moving on to the second, as this was crucial to ensure that the desired data would be obtained. The first questionnaire was designed to primarily determine the level of the participants' financial and tax literacy, whereas the purpose of the second was to determine whether improved financial and tax literacy could improve financial independence. The latter was achieved by providing the participants with more information and background on tax-beneficial investments before they answered the questions. As this was a structured questionnaire, all the participants were asked the same questions, which were multiple-choice questions that provided options to suit all levels of financial and tax literacy.

All the questions, as well as the rationale behind their inclusion, are discussed below:

First questionnaire

The first questionnaire was designed and compiled in such a way that the answers would provide the researcher with insight into, inter alia, the participants' levels of financial and tax literacy. It consisted of 10 multiple-choice questions.

Question 1:

This question was asked as an introduction and to determine whether the participants knew anything about the retirement reform and, if they did, what the level of their knowledge was.

Question 2:

This was another introductory question and was intended to determine what the participants knew about tax-free savings accounts. Both Question 1 and Question 2 were also asked to determine whether the participants were in a position to intentionally benefit from the benefits provided by the relevant financial vehicles.

Question 3: Which of the following statements

The objective of this question was to determine whether the participants understood the term financial independence and what it entails, and whether it was likely that they knew how they could become financially independent since it is unlikely that a person will be able to achieve financial independence if he or she does not understand exactly what it involves.

Question 4: Are you currently saving on a

The objective of this question was to determine whether participants were saving for retirement and what financial vehicles they were using for that purpose, and why those who were not saving were not doing so. It was also asked to determine whether the participants actually understood the funds/investments in which they were investing.

Question 5: If you selected any of the 'yes' answers in the previous question,

Question 5 expanded on Question 4 and was asked to determine whether the participants understood the financial and tax benefits of the funds/investments in which they were investing. Their answers would also indicate whether they had any idea of the amount that would be sufficient for retirement and whether they had planned their financial affairs as tax effectively and tax efficiently as possible.

Question 6: When you consider increasing your ability to save money, this refers to ... (Please select the three options that you feel are the most relevant.)

The objective participants' perceptions regarding saving. The answers could indicate whether they were likely to increase their ability to save.

Question 7: When considering starting to save

This question was asked to determine which motive/driver was most likely to motivate the participant to start saving or to save more.

Question 8: When considering starting to save or increasing your savings ... the main reason for not saving currently or for saving more would be ...

The objective factors would prevent participants from not saving and how they felt about saving. The answers would indicate whether it was possible for the participants to increase their ability to save.

Question 9:

The objective of this question was also to achieve the main purpose of the first questionnaire, which was to determine the participants' levels of financial literacy and whether they had any idea of the amount of funds they would require to support themselves after retiring. It also tested the knowledge of those participants who indicated that they were well-informed on tax and financial matters.

Question 10: Please indicate which of the people

This question was also asked to determine the participants' levels of financial literacy, as well as their attitudes regarding retirement and saving for retirement, and to establish whether they understood the concept compounding.

After the first questionnaire, which was used to establish the participants' level of tax literacy, had been returned, the second questionnaire was sent to them.

Second questionnaire

The second questionnaire, which consisted of seven questions, provided the participants with the necessary information to improve their understanding of tax-beneficial investment funds. Its purpose was to determine whether more knowledge and a better understanding of tax and financial principles might change their views on saving for retirement.

Question 1:

The new retirement reform entails that the tax deduction for employee contributions to pension, retirement annuity and provident funds has been increased to 27.5% (up to a

This question was asked to determine whether the participants were likely to save more if they were aware of the benefits provided by retirement annuities, pension and provided funds.

Question 2:

If in Question 1 you indicated that you would not be encouraged to contribute more to provide for your retirement, please consider the

This question was asked to determine whether the participants who indicated that the benefit explained in the previous question would not encourage them to save more would perhaps change their minds if said benefit had been explained and put into perspective.

Question 3:

A tax-free savings account is a financial vehicle that can be used by South African residents to make contributions to savings accounts

This question was designed to determine whether the participants were likely to save more if they were adequately informed of the benefits offered by tax-free savings accounts. This question also aimed to determine why the participants would not save more, even if they possessed the relevant knowledge.

Question 4:

If in your answer to Question 3 you indicated that you would not be encouraged to save, please consider the following: (If you

The objective of Question 4 was to determine whether the participants who indicated that the benefit mentioned in the previous question would not encourage them to save more would perhaps have changed their minds if the abovementioned benefit had been explained and put into perspective.

Question 5:

If you are told that a person who is currently 30 years of age earns R35 000 per month and wishes to retire at the age of 60 will need R48 113 810 in savings/investments if he wishes to maintain his current standard of living after retiring, this will ...

This question was asked to determine whether the participants would be encouraged to save or save more for retirement if they realised how much money they would need to live relatively comfortably during retirement. This would again indicate whether financial literacy could encourage people to save more.

Question 6: If you were told that a person who started contributing R5 000 per month to a growth trust with a growth rate of 12% from the age of 25 until he reached the age of 60 will have R8 755 906 more than a person who had invested R12 500 per month in the same unit trust from the age of 35, and R21 016 636 more than a person who had invested R12 500 per month in a bank account that ... the age of 25, this would ...

The objective ... her obtaining more knowledge could encourage pa... towards retirement.

Question 7: From what I learned in the survey ...

This question was asked to determine how increased knowledge would affect the attitudes of the participants with regard to saving more for retirement.

3.4.3. <u>Pre-testing</u>

The interview questions were pre-tested by the researcher's supervisor and other individuals from different backgrounds. Comments and recommendations were evaluated and incorporated where applicable.

3.5. DATA ANALYSIS

As previously explained, the data collection was conducted by means of an online questionnaire that was completed by 35 participants.

The data was captured on an online database that could not be manipulated or tampered with. The responses were pulled through as indicated on the database. Therefore the accuracy could be reviewed back to the database and verified. The database enabled the researcher to summarise the results provided by the answers to the questions contained in the questionnaire and present them in graphs and tables that are easy to analyse.

3.6. ASSESSING AND DEMONSTRATING THE QUALITY AND RIGOUR OF THE RESEARCH DESIGN

3.6.1. Source of bias that could influence the research findings

Due to the nature and limitations of an online survey, concerns may be raised as to whether the participants' responses and the results obtained can be regarded as representative of the relevant group of people. Concerns regarding the reliability of the study could also arise because of the fact that the sample selection and survey questions used for this study were based on a criterion set by the researcher according to his personal judgement.

The following types of reliability bias should be considered:

- Computer literacy bias. This bias occurs when participants are computer illiterate and uncomfortable with computers. This could lead to inaccurate responses or no responses at all. The participants in this study had to have access to a computer, know how to use it and be familiar with sending and receiving emails.
- Internet access bias. This type of bias occurs when participants have no internet access, or limited or poor access, which could result in no information, or incomplete information. This also requires the participant to understand how the internet works and to be able to use it.
- Research topic bias. This bias occurs when the participant is either not sufficiently enticed or not sufficiently interested in the research topic to participate in the survey, which could lead to inaccurate results as participants who are not really interested in the study are likely to answer differently from those who are interested in the research topic.

Since this study has a qualitative component, a further concern is the generalisation of the results obtained. The extent to which the findings of the research can be applied to other situations could also be of concern (Saunders *et al.,* 2012:382).

3.6.2. Criteria and techniques used to provide evidence of the quality, credibility and rigour of this study

As shown in 3.6.1 above, one of the main concerns is the standardisation and generalisation that may occur in this study due to sample bias. However, it should be borne in mind that the research focused on a specific group as the researcher believed that the findings based on the responses of that group would have the biggest impact and were of most relevance. Even though in theory this may present an obstacle and might hold truth to a wider population, the researcher believes that the findings are applicable to the identified group if the following is considered:

- As the study focused on literate South Africans between the ages of 18 and 40 who received some form of monthly income, it was more than likely that, considering their ages and literacy levels, the selected participants would be computer literate. Moreover, in the contemporary world it is unlikely that the selected group would be able to function if they were not computer literate. Furthermore, the online survey process is very simple and does not require a high level of computer skills. This would also hold true for the second consideration, which is ease of internet access and should not have been a problem for the selected group. Currently the internet can be accessed through different channels, including cell phones and Wi-Fi hotspots. Most of the participants were also likely to have access to the internet in their work environments. The researcher was therefore of the opinion that internet access would not jeopardise the reliability of the study.
- Research topic bias is an obstacle that is likely to occur in most internet-based questionnaires (Leedy & Ormrod, 2010:215). Therefore this bias should be assessed for each individual study and cannot be generalised. Some research topics are based on very personal and confidential information that may discourage participation. This study did not require information that could jeopardise the participants' privacy and

confidentiality. Therefore this should not be an obstacle. The researcher also aimed to obtain a high response rate, which would have overcome this bias.

- When considering the generalisation of the results that were obtained, the researcher did not attempt to apply the results to other groups that might possibly have responded differently. As mentioned with regard to the limitations of the study, it is likely that results from different groups with different backgrounds may vary. Since the results obtained through this study were not generalised to all South Africans, but focused on a selected group, it is believed that the sample method would still provide a high level of accuracy.

3.6.3. Ethical clearance

Ethical clearance for this research was obtained from the Faculty of Economic and Management Sciences of the University of Pretoria.

3.6.4. Informed consent

Appendix B contains the informed consent letter that was used for this study. It addresses the following issues:

- Anonymity and confidentiality. To achieve the purpose of this study, an anonymous survey was used. The participants' names did not appear on the completed questionnaires and the answers provided were treated as strictly confidential. The participants could not be identified based on the answers that were given.
- Voluntary participation. Participation was voluntary and participants were free to choose to complete the questionnaire, or to withdraw at any time without even informing the researcher.
- The results of the study will be used for academic purposes only. Participants will be provided with a summary of findings on request.

Participants were requested to read the informed consent letter and to only click on the link to participate in the questionnaire once they had read and understood the information.

By clicking on the link, participants agreed to voluntarily participate in the study. No incentives were offered to entice participation.

In the following chapter the answers to the questions asked the questionnaires are analysed.

CHAPTER 4:

ANALYSIS OF THE RESULTS

4.1 INTRODUCTION

In the previous chapter the methodology employed to determine whether tax and financial literacy could improve retired South Africans' level of financial independence were described and explained. This chapter contains a discussion and examination of the data that was collected from the completed questionnaires received from 35 participants.
The results and analysis of each question will be explained point by point per question. Where considered necessary, graphs and charts will be used to illustrate the data.

4.2 ANALYSIS OF RESULTS

4.2.1 Questionnaire 1

The aim of the first questionnaire, which consisted of 10 multiple-choice questions, was to determine the participants' levels of financial and tax literacy.

Question 1: Do you know about the new retirement reform and what it entails?

In response to this question, 47.22% of the participants indicated that they had never heard of the retirement reform. Only 13.89% indicated that they had a sound knowledge and understanding of what it entailed. The remaining 38.89% indicated that they knew about the reform, but were uncertain about the details.

At first glance, the fact that almost half of the participants had never heard of the retirement reform could be worrying. However, it is possible that they might have heard about it but were unfamiliar with the term retirement reform. What this probably does indicate is that at least 86.11% of the participants were not well informed about the retirement reform and most likely did not understand the principle. Of the 13.89% who indicated that they did have good knowledge thereof, 80% also indicated that they were considering making use of it or were already doing so. This indicates that only 13.89% of the participants were in a position to intentionally take advantage of the benefits provided by the retirement reform. It might also indicate that informed South Africans are likely to make use of these benefits.

Question 2: What is a tax-free savings account?

The responses to Question 2 were somewhat more promising as only 8.33% of the participants indicated that they had never heard of a tax-free savings account. A relatively high 58.33% indicated that they had sound knowledge of tax-free savings accounts and should therefore be in a good position to determine whether they would be good savings vehicles. However, 22.22% of those participants indicated that even though they were aware of the advantages offered by such accounts, they were not considering making use of them. This indicates that those participants did not recognise a tax-free savings account as a beneficial savings vehicle. Even though this should theoretically indicate that more South Africans are in a position to intentionally benefit from tax-free saving accounts, it is questionable whether they truly understand the benefits provided by such accounts. The other 33.34% indicated that although they were aware of the existence of tax-free saving accounts, they were uncertain about the details.

The fact that more participants knew what a tax-free savings account is, could be due to the fact that such accounts have been in use for longer and have been advertised extensively by many of the service providers. This might also indicate that South Africans are willing to investigate possible saving opportunities that are brought to their attention.

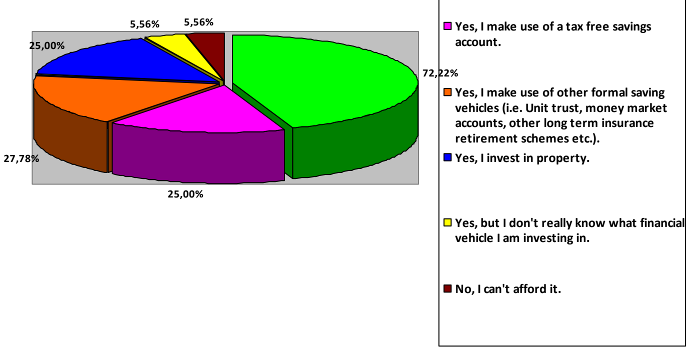
Question 3: Which of the following statements best describes the term financial independence?

The answers to this question contained a strong indication that being debt free was perceived as being financially independent. A total of 41.67% of the participants indicated that receiving a fixed salary and being debt free meant that they were financially independent. A further 38.88% were of the opinion that being financially independent means having sufficient personal wealth to live without having to work actively. The remaining 19.45% chose other incorrect options. It was therefore evident that more than 66% of the participants did not really understand the term financial independence.

Question 4: Are you currently saving on a monthly or yearly basis for your retirement? (You may select as many options as are applicable.)

In this question the participants were provided with possible options in which they could save for retirement. They could select as many options as were applicable to them. Figure 7 clearly indicates that the vehicles that were mostly utilised by the participants to save for retirement were retirement annuities and pension and provided funds (72.22%). Therefore even though the majority of the participants did not know about or understand the term retirement reform (s Question 1), they were already making use of this benefit and should be in a good position to optimise it.

Figure 7

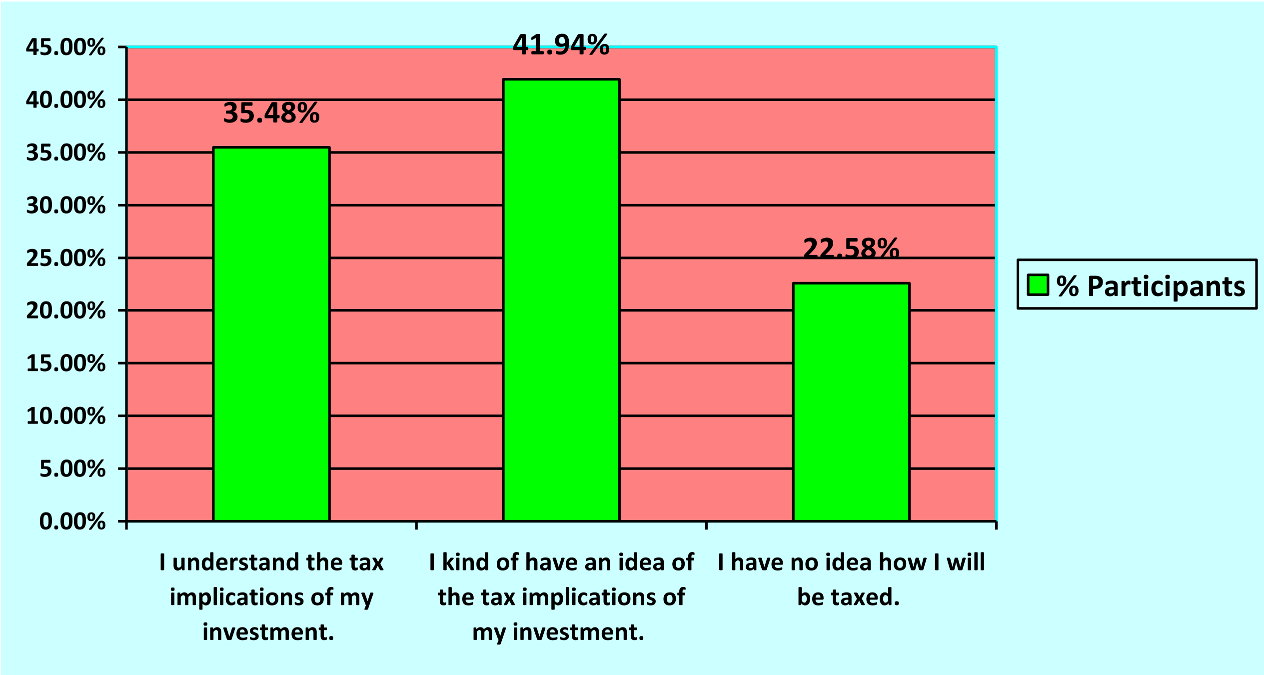


The third most used vehicle to save for retirement was investment in property (25%). An aspect that may need to be clarified in this regard is whether participants who were paying a mortgage on the house in which they were living perhaps perceived that as an investment in property. Tax-free savings accounts were being used by 25% of the participants and 27.78% made use of other formal saving vehicles.

Question 5: If you selected any of the 'yes' answers in the previous question, please indicate ... (Please select one of the tax-related answers (2–4) and one of the finance-related answers (5–7); if you selected a 'no' answer, select N/A here.)

In order to determine whether the participants understood their investments, this question provided them with three options relating to tax and financial implications. The responses indicated that although the majority (41.94%) of the participants (who were saving for retirement) indicated they did have some idea of how they would be taxed on their investments, they were not confident enough to indicate that they were sure about the tax implications of their investment. It was also revealed that 22.58% had no idea how they would be taxed on their investments.

Figure 8



As in the case of the tax aspect of the investment, the majority (60.86%) of the participants indicated that they had some idea of what their investments would be worth on retirement, but were not sure that that would be enough. As indicated in Figures 8 and 9, 35.48% were confident that they understood the tax implications of their investments, and 30.43% were confident that their investments would be sufficient for retirement.

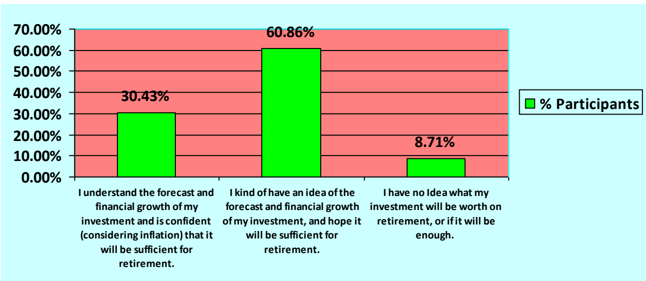


Figure 9

<u>Question 6: When you consider increasing your ability to save money, this refers to ... (Please select the three options that you think are the most relevant.)</u>

This question provided the participants with six options from which they were asked to select three in order to indicate what they considered to be the best options for increasing their ability to save money.

Figure 10

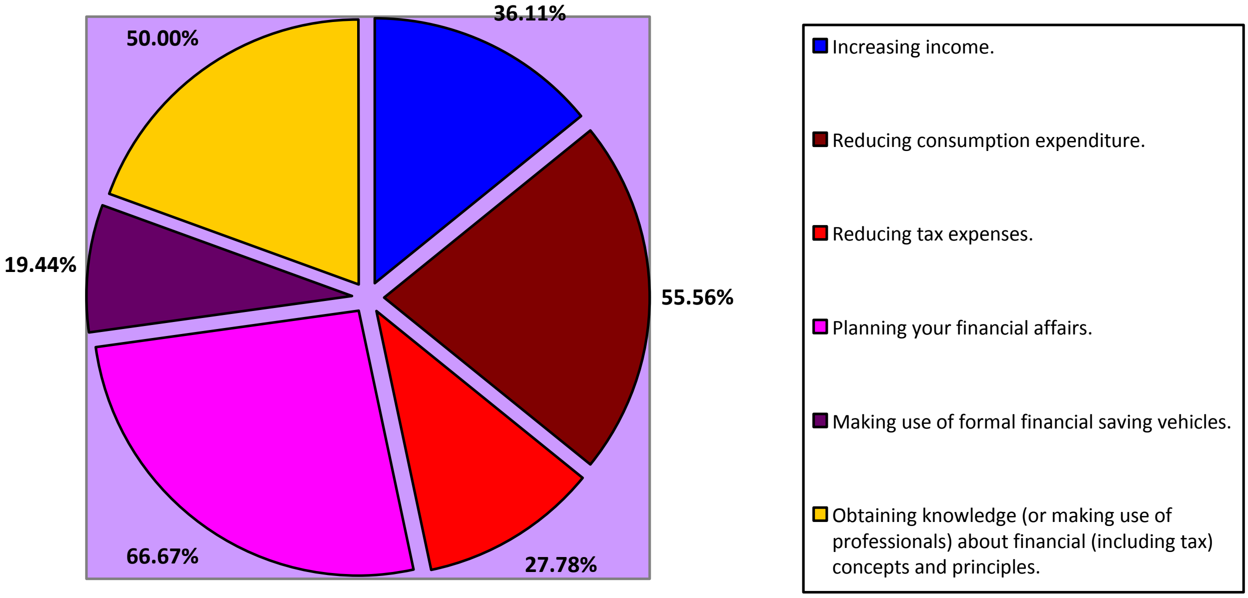


Figure 10 clearly indicates that the top three ways in which the participants felt they were able to increase their ability to save were: 1. planning their financial affairs (66.67%); 2. reducing consumption expenditure (55.56%); and 3. obtaining knowledge (or making use of professionals) about financial (including tax) concepts and principles (50%). What is interesting about these results is that the majority of the participants indicated that planning their financial affairs could increase their ability to save, even though the previous results clearly indicated that they lacked the knowledge to do so.

<u>Question 7: When considering starting to save or increasing savings ... the main single most important consideration would be...</u>

The approach to this question was to provide the participants with four considerations that might motivate them to save or increase their savings. They were allowed to select only one answer and would therefore indicate the consideration that is most likely to encourage saving.

Nearly 56% of the participants indicated that the single most important consideration would be to increase their level of financial independence during retirement, while 19.44% considered building their wealth as the most important and 19.44% indicated that saving for a house, a car or a similar asset would be their main consideration. Only 5.55% indicated that education (for themselves or their children) would be their most important reason for saving.

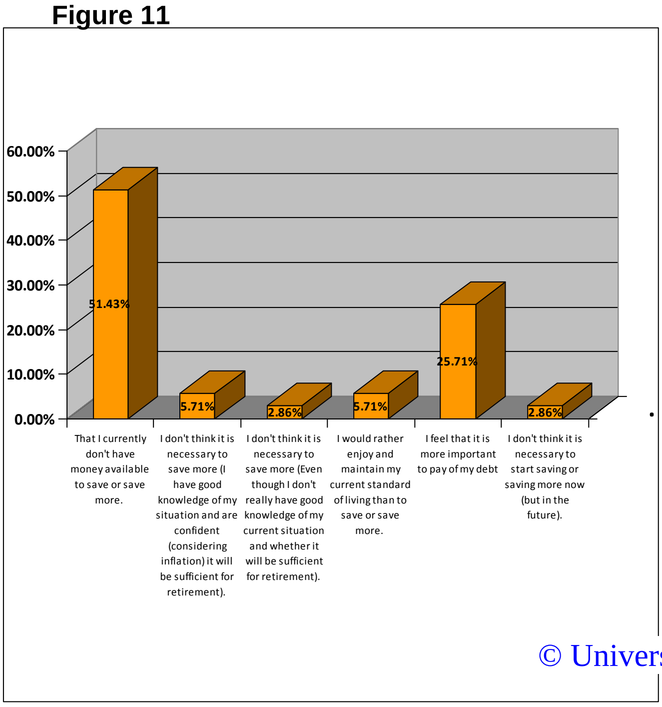
<u>Question 8: When considering starting to save or increasing savings ... the main reason for currently not saving or not saving more would be ...</u>

As in the case of Question 7, the participants were provided with a number of obstacles that might prevent them from saving or starting to save more. They were asked to select only one option in order to determine what the primary obstacle was. Figure 11 clearly indicates that, as was found in previous studies, the main obstacle was that their current incomes made it impossible for them to save or save more (51.43%).

What also clearly stood out was that 25.71% felt that even though they did have money available to save, they preferred to rather pay off their debts than to save more. This also quantifies the findings based on the responses to Question 3 regarding their perception of what financial independence entails.

More concerning, however, is the fact that 5.71% of the participants felt that they would rather maintain their current standard of living than save for retirement. Only 5.71% indicated that they did not think that it was necessary to save more as they had made sufficient provision for their retirement.

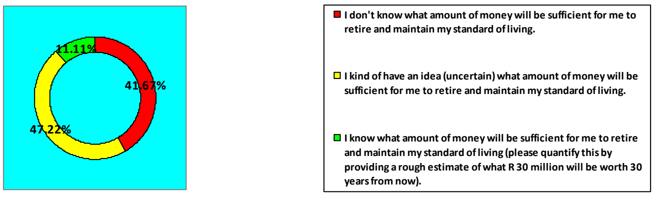
Figure 11



<u>Question 9: Please indicate one of the following ...</u>

In Question 9, the participants were given three possible options in order to determine their levels of understanding with regard to the amount of funds that would be sufficient for their retirement. Only 11.11% of the participants indicated that they did know how much they should save to ensure that they would be able to retire comfortably. The rest (almost 90%) either had no idea, or just a vague idea of what would be a sufficient amount.

Figure 12



Question 10: Please indicate which of the people in the following scenarios would, in your opinion, be in the best financial position when they retire at the age of 60.

In order to determine whether the participants understood the principle of compounding, three scenarios were sketched and they were asked to select the scenario that, in their opinion, would result in the best financial position at the age of 60. In the first scenario a couple invested R5 000 per month in a unit trust with an annual growth rate of 12% from the age of 25. In the second scenario R12 500 per month was invested in the same unit trust from the age of 35, and in the third R12 500 was invested monthly in a bank account at an interest rate of 4.5% from the age of 25.

A total of 83.33% of the participants correctly indicated that the first person would be in the best financial position. Although many of the participants might have guessed, this does indicate that the majority might have heard about or really understood the concept of compounding. Of the remaining 16.67%, 5.57% selected incorrect options and 11.11% indicated that they had no idea, but would like to know the answer to the question.

4.2.2 Questionnaire 2

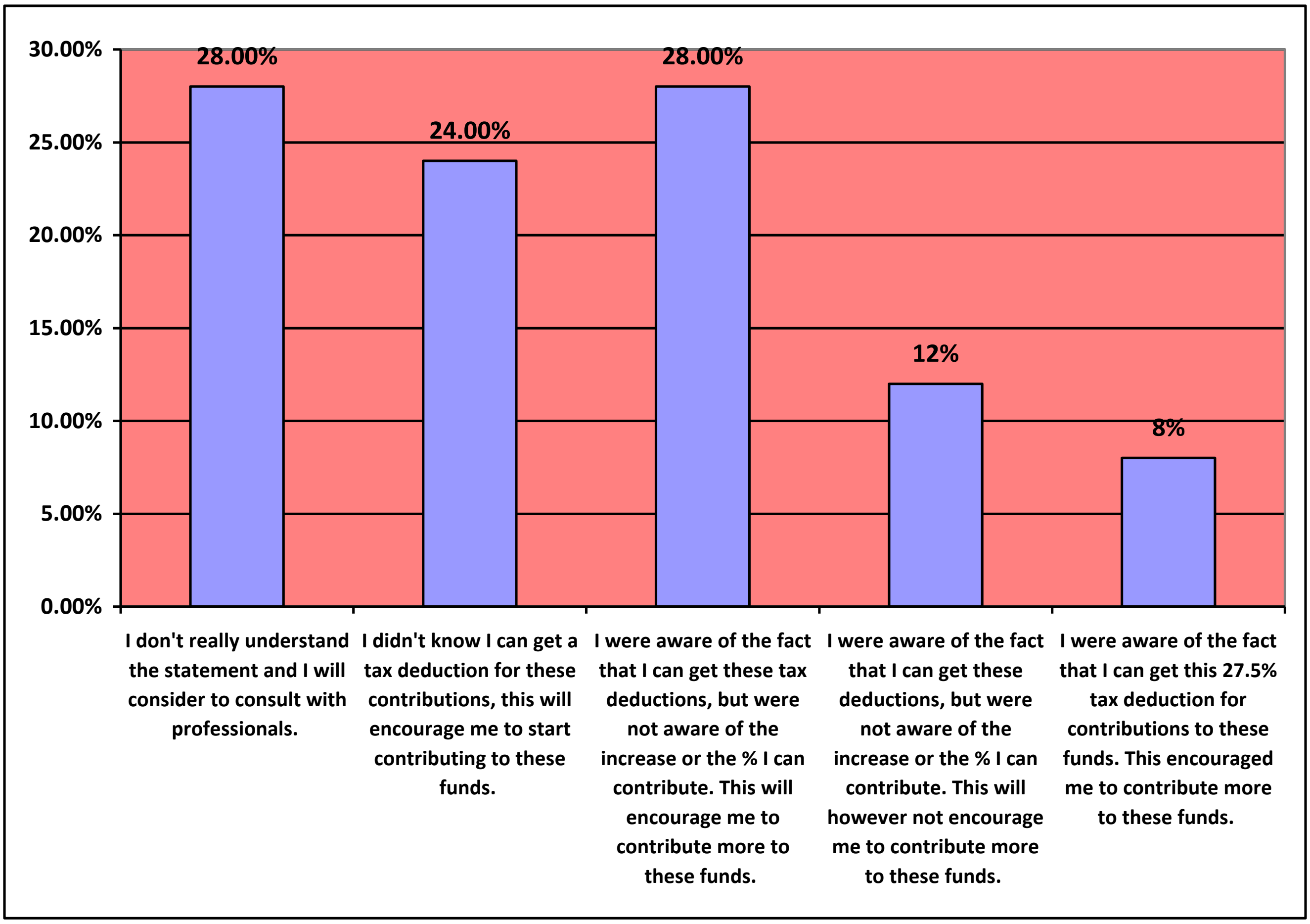
The purpose of the second questionnaire, which contained seven questions and had been designed to provide the participants with more insight and enough background information to enable them to provide informed answers, was to determine whether they might act differently if they were better informed about tax and financial concepts and principles.

Question 1: The new retirement reform entails that the tax deduction for employee contributions to pension, retirement annuity and provident funds are increased to 27.5% (up to a cap of R 350,000) of the greater of taxable income or remuneration. In other words, you can contribute 27.5% of your salary to any of these funds without paying tax on the income distributed/paid to these funds. Therefore, for every R1 you would invest in other after-tax investments, you would be able to invest R1 + the tax portion. A person who falls within the 41% tax bracket would, for instance, be able to invest R1.69. Please select one of the following ...

The first question of the second questionnaire briefly explained what the retirement reform entails. After being given this information, the participants were asked to indicate whether their improved understanding of the tax reform principle would encourage them to start contributing, or to contribute more to a qualifying retirement fund.

Even after reading the explanation, 28% of the participants did not grasp this principle, but indicated that they would consider consulting professionals. A further 24% had been unaware of the tax deductions that are available to contributors to appropriate funds, but were encouraged by what they learnt and were considering starting to contribute to such funds. The 28% who had not been aware of the increase in the deduction indicated that it would encourage them to contribute more to those funds, and the 8% who indicated that they had been aware of the increased tax benefits stated that they were encouraged by the increase to save more. A total of 60% of the participants were therefore encouraged to save more once they had been informed. With regard to the 28% who did not understand the explanation, it is possible that once their understanding had improved they would also be encouraged to take advantage of the benefits offered by the tax reform.

Figure 13



Question 2: If in Question 1 you indicated that you would not be encouraged to contribute more to provide for your retirement, please consider the following (if you chose any of the 'yes' answers in Question 1, please select N/A). If you had been told that a person who earns a taxable income of R600 000 per year and utilises the benefit mentioned in Question 1 in full, the total tax saving could be worth R6 200 000 after 25 years, would this have influenced your answer to Question 1?

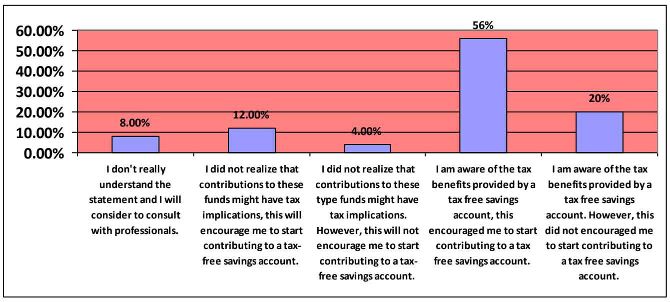
In response to Question 1, 12% of the participants indicated that they would not be encouraged to save more. Question 2 asked those participants to reconsider their responses once the effect of the abovementioned benefit had been illustrated in a practical way. This led to a response that indicated that once they had realised the effect of the benefit, 75% of those participants changed their minds and indicated that they would be encouraged to contribute more. We can therefore accept that 69% of the participants were encouraged to contribute or contribute more once they had been informed.

<u>Question 3: A tax-free savings account is a financial vehicle that can be used by South African residents to make contributions to savings accounts, unit trusts or other funds from their post-tax salaries. The benefit provided by a tax-free savings account is that all returns, income (i.e. interest and dividends) and capital (i.e. capital growth of investment) of any nature will be exempt from income tax. The contributions will, however, be limited to R30 000 per year and R500 000 over a lifetime.</u>

This question provided the participants with a brief explanation of the benefits offered by a tax-free savings account, after which they were asked to indicate whether they understood the principle and whether it would encourage them to start contributing, or to contribute more to those funds.

As in the first questionnaire, the responses with regard to tax-free savings accounts were more promising as 76% of the participants were aware of the tax benefits provided by a tax-free savings account. Of this 76%, 56% were encouraged to start contributing to a tax-free savings account. Of the 24% who were not aware of these benefits, 12% indicated that once they had been informed, they were encouraged to start making use of tax-free saving accounts. The 8% who did not understand the principle indicated that they would consider consulting with professionals. It can therefore be accepted that at least 68% of the participants were encouraged to start making use of tax-free savings accounts once they understood the benefits offered by such accounts.

Figure 14



<u>Question 4: If in your answer to Question 3 you indicated that you would not be encouraged to save, please consider the following (if you had selected any of the other answers in Question 3, please select N/A here). If you had been told that by making use of a tax-free savings account, as opposed to an ordinary unit trust, your tax saving could be worth R625 435 after 25 years, would this have influenced your answer to Question 3?</u>

Following on Question 3, Question 4 focused on the participants who had indicated that they would not be encouraged to make use of a tax-free savings account. Question 4 illustrated the benefits provided by a tax-free savings account and then again asked those participants (24%) to indicate whether knowing about the benefits might cause them to change their minds. Of the 24%, 83.33% then indicated that they would be interested in making use of the benefits offered by a tax-free savings account. This means that, once they understood the benefits, a total of 88% of the participants were encouraged to start making use of tax-free savings accounts.

Question 5: If you are told that a person who is currently 30 years of age, earns R35 000 per month and wishes to retire at the age of 60 will need R48 113 810 in savings/investments to be able to maintain his standard of living during retirement, this would ...

In this question, an estimate of the amount that a person who earns R35 000 per month and would like to maintain his standard of living after retirement was presented to the participants. They were then asked to indicate whether this information would encourage them to save more. Only 12% of the participants indicated that they would not be encouraged to save more. Of this 12%, 8% indicated that the reason for not saving more was that they were confident that their savings would be sufficient for retirement. The other 88% indicated that they would be encouraged to save more. It can therefore be stated that once the participants had been provided with this information, 88% felt that they were currently not saving enough for retirement.

Question 6: If you were told that a person who contributed R5 000 per month in a unit trust with a growth rate of 12% from the age of 25 until he reached the age of 60 will have R8 755 906 more than a person who started investing R12 500 per month in the same unit trust from the age of 35, and R21 016 636 more than a person who had started investing R12 500 per month in a bank account earning 4% interest per annum from the age of 25, this would ...

Since it was expected that this statement would encourage the participants to start saving as soon as possible, the options from which they could choose also required them to indicate whether they would be willing to lower their current standard of living in order to be able to do so. All the participants indicated that this would in fact encourage them to start investing and saving as soon as possible, and 79.16% indicated that they would be prepared to lower their current standard of living in order to start saving earlier. The remaining 20.84% indicated that they would start saving as soon as their incomes increased.

<u>Question 7: From what I learned in the survey ...</u>

In order to determine whether the information that was provided to the participants in the questionnaire would encourage them to increase their level of financial and tax literacy or make use of the services offered by professionals, they were provided with three options. Only two of the options seemed to be relevant. A total of 96% of the participants indicated that what they had learned from the survey had encouraged them to either increase their financial and tax knowledge, or consult with professionals. They also indicated that they believed that this could increase their level of financial independence during retirement. Only 4% indicated that they felt that they already had enough knowledge or had already consulted with professionals.

4.2 CONCLUSION

This chapter focused on the examination and analysis of the responses obtained from the two surveys/questionnaires that had been emailed to the participants. In Chapter 5 a conclusion will be drawn based on the results discussed in this chapter.

CHAPTER 5:

SUMMARY AND CONCLUSION

5.1 INTRODUCTION

The primary goal of this study was to determine whether improved tax and financial literacy has the ability to increase people's awareness of the importance of financial independence during retirement. The main research objectives were:

- To determine the financial and tax literacy of South Africans, regarding financial independence during retirement.
- To determine the extent to which South Africans are willing to save, and whether their ability and willingness to save will increase once they have gained gain a better understanding of tax and financial concepts and principles.
- To conclude whether tax and financial literacy can increase financial independence during retirement.

This chapter will provide an overview of the study, which will lead to a conclusion. It will also contain a synopsis of the research methodology that was applied to answer the research questions and achieve the research objectives. These research objectives will also be evaluated to determine whether the study achieved the desired outcome.

The outcome of the study will determine the value it contributes to this specific field. Suggestions and recommendations will also be made with regard to how individuals could enhance their level of tax and financial literacy. This will be followed by suggestions for future research.

Finally, an overall conclusion to this study will be presented.

5.2 METHODOLOGY

The aim of this study was to determine whether tax and financial literacy could potentially improve South Africans' level of financial independence during retirement. Although different methods and vehicles were utilised to achieve this, the aim of the study was not to identify the best methods or vehicles.

In order to collect the data required for this research, two separate questionnaires/surveys were compiled and sent to a selection of potential participants by email. The targeted population consisted of literate and educated South African citizens between the ages of 18 and 40 who receive some form of monthly income. This group was chosen as it was believed that they are likely to derive the most benefit from the findings of this study. The first questionnaire was completed by 35, and the second by 25 respondents.

The first and second questionnaires consisted of ten and seven questions respectively. Both were designed to provide quantitative and qualitative data. The participants were required to first complete the first questionnaire before moving on to the second. This was crucial to ensure that the desired data would be obtained.

The first questionnaire was designed primarily to determine the participants' level of financial and tax literacy. The second set of questions was used to determine whether financial and tax literacy could potentially increase savings, and therefore also financial independence. Since this was a structured questionnaire, all the participants were asked the same questions and provided with the same answers to choose from. Furthermore, the questionnaires consisted of multiple-choice questions and the answers provided to choose from were suited to participants with different levels of financial and tax literacy. Some of the questions did provide participants with an option to comment so as to ensure that they would not feel obligated to select an answer they did not wholly agree with. The data was captured on an online database that could not be manipulated or tampered with.

5.3 ADRESSING THE RESEARCH OBJECTIVES

To determine whether this study succeeded in achieving the research objectives, each objective will now be evaluated in terms of the data collected by means of the questionnaires.

5.3.1. Research objective 1: To determine the financial and tax literacy of South Africans, regarding financial independence during retirement.

The questions that focused mainly on this first research objective will be discussed separately. The assigning of several questions to this objective can be justified by the different levels and different aspects that should be considered. Therefore each of these questions will be applied to this objective to determine the contribution of each. The data obtained from the responses to Question 1 in the first questionnaire indicated that only

13.89% of the respondents were well informed on and understood the principle behind the retirement reform. This therefore indicates that 86.11% of the participants did not have good knowledge of the retirement reform and were not in a position to intentionally benefit from the benefits that it offers. These statistics were quantified by the data from Question 1 in the second questionnaire, where only 8% of the participants indicated that they were aware of what the increased deductions allowed in respect of contributions to the relevant funds. However, 40% of the participants knew that they could get a deduction for contributions to the applicable funds, but were unaware of the increase in the percentage of the deduction allowed. Moreover, in Question 1 of the second questionnaire, 12% of the participants who had indicated that they were aware of the deductions also indicated that they would not be encouraged to invest more into those funds. However, after the effect of these deductions had been illustrated in Question 2,75% of the participants changed their minds.

The data obtained from the responses to Question 2 indicated that 58.33% of the participants were well informed on and understood the principle of a tax-free savings account. Question 3 of the second questionnaire quantified this when 56% of the participants indicated that they understood and were contributing or considered contributing to a tax-free savings account.

In Question 3 only 38.88% of the participants indicated that they understood the term financial independence, and in Question 5 only 35.48% indicated that they understood the tax implications of their current investments and only 30.43% indicated that they understood the financial forecasts for their investments. Therefore 64.52% of the participants did not fully understand the tax implications of their investments and 68.57% did not fully understand the financial forecasts of their investments.

The responses to Question 9 indicated that only 11.11% of the participants knew how much money would be required to ensure that they would be able to maintain their standard of living after retiring. Therefore 88.89% of the participants were uncertain and unable to calculate how much they would need to save for their retirement.

Overall the level of financial and tax literacy of the majority of the participants can be summarised as not sufficient to enable them to intentionally benefit from the benefits available to them.

5.3.2. **Research objective 2: To determine the extent to which South Africans are willing to save, and whether their ability and willingness to save will increase once they have gained gain a better understanding of tax and financial concepts and principles.**

Several questions were asked to address this objective. In order to evaluate the degree of success with which this objective was achieved, the data obtained from the responses to these questions need to be combined and examined together.

The data obtained in response to Question 4 of the first questionnaire indicated that 72.20% of the participants were at the time contributing to retirement annuities, pension and provided funds; 27.78% were making use of other formal saving vehicles (e.g. unit trusts); and 25% were saving money in tax-free savings accounts. The data provided by Questions 1 and 2 of the second questionnaire indicated that 69% of the participants were encouraged to start saving or saving more in retirement annuities, pension and provident funds once they had been made aware of the benefits available to them. The responses to Question 1 also indicated that 52% of the participants were totally unaware of the fact that they could claim a tax deduction for contributions to these funds.

The data obtained through Questions 3 and 4 of the second questionnaire indicate that 88% of the participants were encouraged to start saving or to save more in tax-free savings accounts once they understood the benefits offered by a such accounts. The data from Question 3 also indicate that 24% of the participants did not realise that investments such as unit trusts might have tax implications, which could be avoided by saving in a tax-free saving account.

When certain scenarios were sketched in Questions 5 and 6 of the second questionnaire, the responses to Question 5 indicated that 88% of the participants were concerned that they were not saving enough for retirement and indicated that this would encourage them to start saving, or to save more for retirement. The data from Question 6 of this questionnaire indicated that 79.16% of the participants would be willing to lower their standard of living in order to start saving more as soon as possible. The remaining 20.84% indicated that they would start saving as soon as their incomes increased.

The data collected from responses to the questions discussed above indicates that once the participants had been informed in this regard, they were encouraged to start saving or to save more. In some instances the responses even indicated that this information had resulted in a feeling that attending to this was a matter of some urgency. Many of the participants were already saving and could therefore optimise and plan their financial affairs better once they had acquired the necessary knowledge to do so.

The responses to Question 8 indicate that 51.43% of the participants' main reason for not saving more was that they simply could not afford it. However, as indicated in the study, those participants could increase their savings by planning their financial affairs and reducing consumption and tax expenses.

5.3.1. Could tax and financial literacy increase financial independence during retirement?

In the case of the aforementioned two objectives, the data obtained from the surveys indicate that financial and tax literacy could indeed increase savings and therefore also financial independence. However, a factor that will be decisive in this regard is whether the participants themselves are of the opinion that increasing their knowledge of the benefits attached to different forms of saving will play a role in increase their level of financial independence.

This objective is addressed by Question 7 of the second questionnaire. The data collected from this question indicated that 96% of the participants were encouraged by what they had learned from the surveys to gain more financial and tax knowledge or consult with professionals.

5.4 CONTRIBUTION OF STUDY

Academically, the findings of this study enhance our understanding of the relationship between individuals' financial and tax literacy and their ability to increase their level of financial independence. The data obtained from the questionnaires demonstrates that if South Africans increase their level of financial and tax literacy, they will be willing and able to increase their savings towards retirement.

In practice the outcome of this study can assist individuals as well as the government to identify the obstacles that are preventing South Africans from saving for retirement. This could therefore assist in increasing the effectiveness of tax incentives and optimising financial planning. What did stand out in the study is that many South Africans are unaware of the vehicles available to them to increase their ability to save. To counter this obstacle and create an awareness of the importance of saving among South Africans, the government and even education institutions should implement programmes to inform people and should publicise these saving opportunities more aggressively.

By identifying the factors that could potentially encourage the development of a culture of saving among South Africans, this study may assist individuals, as well as the government, in finding solutions to the obstacles that are currently preventing South Africans from saving more for retirement. If these obstacles can be overcome, it is likely that South Africans will be able to increase their level of financial independence during retirement and become less reliant on government or family support. Recommendations for achieving this are discussed in 5.4.1 below.

5.4.1. <u>Recommendations</u>

The data obtained from the study indicate that once the participants had been made aware of the availability of formal savings vehicles that could increase their savings, and also of how important it was to calculate roughly how much they ought to save to ensure that they would be able to maintain an acceptable standard of living after their retirement, they were encouraged to save more. The majority even indicated that they would be prepared to lower their current standard of living to do so.

The main problem was that initially the participants were unaware of these vehicles, and were consequently unable to investigate and utilise them. It is therefore recommended that government should publicise and also make use of the media to create awareness of these financial vehicles among South Africans. It is further recommended that information sessions should be initiated, and even that short course should be presented to university students and matric learners to trigger their interest and initiate further investigation.

Another obstacle was that even though some of the participants were aware of availability of these vehicles, they did not fully grasp the benefits provided by them. One recommendation in this regard is to introduce a mandatory subject at high school and/or universities to teach young South Africans how to effectively plan their financial affairs. Professionals in the field should also be approached to share their expertise with the learners/ students. As indicated, 96% of the participants were keen to increase their level of financial literacy or seek advice about financial planning/saving from professionals.

5.4.2. Suggestions for future research

This study focused on whether financial and tax literacy could improve the level of financial independence of retired South Africans. Although examples of different formal financial vehicles were used to illustrate the benefits that are available locally, a more in-depth study to determine which financial vehicles would be the best and the most effective (taking into account the different growth rates and risks involved) could add considerable value.

This study focused on literate and educated South Africans between the ages of 18 and 40 who earned some form of income. The research could be expanded to other target groups in order to obtain data from a larger spectrum of the overall population.

Another aspect that could be researched and would be both interesting and add value, would be to determine whether South Africans who are already retired are financially and tax literate, and whether they feel that being financially and tax literate (or using professional services) had impacted their standard of living after retirement.

5.5 CONCLUSION

The study succeeded in answering the main research questions.

The data obtained by means of the questionnaires indicated that the level of financial and tax literacy of the majority of South Africans can be summarised as not sufficient to intentionally benefit from tax-beneficial retirement funds and investments. Only 11.11% of the participants knew how much they would need to save in order to ensure that they would be able maintain their standard of living once they were retired. This means that 88.89% of the participants were uncertain and unable to calculate how much they needed to save for their retirement. Furthermore, only 13.89% felt that they were well informed and understood the principle behind the retirement reform. Although 41.94% of the participants indicated that they were to some extent aware of the tax implications of their investments and 60.86% indicated they had some idea of the financial forecast for their investments, only 35.48% were confident that they understood the tax implications of their investments and only 30.43% stated that they were fully aware of the financial forecasts for their investments.

It can be concluded that although the majority of South Africans are not sufficiently financially literate to be able to optimise their financial affairs, they are willing to increase their level of financial and tax literacy, either by equipping themselves or by seeking advice form professionals. Furthermore, it can be concluded that once South Africans are informed, they are willing and keen to save more towards retirement. It can therefore be concluded that tax and financial literacy has the ability to increase the financial independence of South Africans during retirement.

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