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Wealth Creation
The ownership of valuable resources

What is wealth creation?
Wealth is the ownership of valuable resources. Wealth creation involves the building of assets by means of careful investment, usually over a long period so as to achieve an income stream that will ensure a continuation of a high-quality lifestyle in the years beyond retirement.

As such, wealth generation can be termed as the accumulation of one's income-generating assets over a long period.

Hindrances for wealth creation

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Generally in South Africa, there is a low savings culture. Although in the formal sector most individuals have some form of formal savings through compulsory membership of retirement funds, members do not generally preserve their retirement benefits when they change employment. What is even more disturbing is that for many people their retirement savings are their only formal savings. In the informal sector, all money generated by the individuals is most often used for day-to-day living. Hence they are unable to save.

Especially for low-income or very poor individuals, the high cost of living, the high cost of debt and high medical costs are all hindrances to saving. There is generally nothing that directly impedes an individual's ability to generate wealth from a tax point of view, provided the taxman gets the applicable taxes on the returns generated by an investment or an enterprise. Currently there are very limited tax incentives to save using post-taxation funds. More can be done to entice members to save for the longer term.

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Some guidelines/principles for wealth creation

There is not a one-size-that-fits-all approach when it comes to wealth creation. The individual should consider his/her own circumstances and preferences. A number of factors need to be considered when looking at wealth-generating opportunities.

An investor should consider:

- Obtaining professional investment advice before making investment decisions
- The type of wealth creation vehicle
- Tax and estate planning
- The relationship between risk and return
- Appropriate and adequate insurance cover to protect him/her and his/her dependants against financial loss in case of death, disability, illness or loss
- The costs of investing

Further considerations include:

1. The timeframe of the investor – more liquid assets will be more appropriate if the investment needs to be realised in the short term. However, equity type of investments are more appropriate for long-term investments. The returns expected will also depend on the nature of the investment.

2. The amount of cash or assets that the individual has – an investor with very limited resources needs to be more prudent in his/her choice of investments, as opposed to someone with ample resources.

3. Diversification – it is always advisable not to put all one's eggs in one basket. It will be wise to have a more diversified portfolio comprising equities property and cash resources.

4. The timing of investments is important. Lump sum investments, if possible, should be staggered over a period so that the whole amount is not invested at the top of the market. The effect of market movements is smoothed in the case of recurring investments.

5. The expected growth of the investments that one chooses should ideally match one's investment needs. It is important to understand that in order to create wealth, the return earned on one's investments needs to exceed the inflationary effect.

The performances of the investments need to be regularly monitored, and changes need to be made as and when necessary. The investment decision is not a once-off decision and should be made for the long term, taking into account the liability and asset profile of the individual.

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Tax, exchange controls and regulatory considerations

Investors need to be aware of the tax, regulatory and exchange implications that are applicable to the vehicles they are using to generate their wealth.

Tax considerations

The most common taxes applicable to wealth generation are Capital Gains Tax, Income Tax and tax on dividends.

It can be argued that the individual tax rates in South Africa are high. For example, most of the other BRICS countries' tax rates are lower than South Africa's tax rates.

The proposed change to the allowable deductions for retirement fund contributions (that is the increase to a total of 27.5% of remuneration or taxable income) shows that the tax authorities are encouraging savings. Although one can say that the capping to R350 000 could be discouraging to some, especially the higher income earners who would naturally have more disposable income for savings.

However, the totality of the compliance obligations involved in respect of the variety of direct and indirect taxes, as well as other non-tax-related aspects (e.g. labour laws) might impede persons from focusing on their business and therefore from creating wealth.

Exchange control considerations

Exchange controls are to be considered when looking at offshore investments. The mere fact that there are exchange controls in place will obviously have an effect on an individual's ability to make cross-border investments and consequently the person's ability to create wealth. Having said that, exchange controls have been substantially relaxed over the past 15 years so that there are now opportunities for individuals to make investments abroad which did not exist before 1997. The Foreign Exchange Control (FEC) regulation limits foreign exchange transfers, and these are regulated by the South African Reserve Bank.

For example: Individuals may now invest up to R5 million per calendar year abroad made up of an investment allowance of R4 million and a discretionary allowance of R1 million. In respect of the investment allowance, a tax clearance certificate is required prior to the individual being able to transfer the funds abroad.

Further, since emigrants are entitled to transfer all their assets abroad (subject to certain conditions), treasury has introduced concessions for South African individuals.

All income earned on legal foreign assets may be retained abroad and used freely, except for reinvesting into South Africa, directly or indirectly, via an offshore entity.

There are also other legal implications on South African resident individuals in borrowing abroad.
There is unfortunately no legal way in circumventing the restrictions. It is, however, Government's stated policy to relax and eventually abolish exchange controls; and while restrictions have been lifted in the past and are likely to continue to be relaxed in time to come, there is no definitive date set for the abolishment thereof.

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Regulatory considerations – Regulation 28 of the Pension Funds Act

Regulation 28 of the Pension Funds Act also imposes certain restrictions on wealth generation. It provides for restrictive investment in certain classes of assets for example the offshore limit where a fund (and at a member level) is restricted to 25% of the total investment. Similarly, investments in equity are restricted to 75%. This means that if an individual's equity investment is performing well and is assisting him/her to generate wealth,
he/she will be forced to reduce this exposure to equity if it has exceeded 75% of his total investment in the fund. Regulation 28 is a prudential regulation with the aim to protect members' benefits and provide adequate prudential limits for the longer term. Preservation and retirement annuity funds also have to comply with Regulation 28 and are not intended to be the only savings for members given the limitation on the various classes of Assets.

Members should supplement their retirement fund savings with other savings and should view savings as a holistic view, taking into account their personal circumstances and lifestyle.

Possible regulatory changes which could encourage saving and wealth creation

- Retirement funds – Contributions to retirement funds up to a percentage of the earnings to be tax deductible. Access to the retirement benefit should only be at the time of retirement.
- Legislative amendment to ensure a limited compulsory investment in infrastructure and power generation projects from the fund. This could assist with infrastructure development, employment opportunities and growth for the country, along with wealth generation for the common man.
- Interest on borrowed funds for construction of a new house (for self-occupation) should only be tax-free up to a certain limit. This will create wealth and significant employment opportunities.
- The tax-free limit on interest from banks and other investments should be significantly increased to encourage savings and investments.
- The use of retail outlets for quick, easy and convenient collection as well as withdrawals of small savings without too many regulatory impediments.

Conclusion

It is always an individual's intention to create wealth but the individual needs to be aware that the path to creating wealth is often strewn with complexities. Individuals need to apply the above wealth-generating principles to the applicable regulatory and tax constraints to create, manage and maximise their wealth.

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