Finance for doctors

Retirement financing strategies

by
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January and February are the months when many doctors' thoughts turn to their retirement annuity funds as a way of easing the burden of tax income.

Contributions to RA's have to be made by February 28 to count as a deduction from gross income in the current tax year.

Because there is no longer a fixed limit in rands on the amount you can contribute to RA's — the limit is now 15 per cent of earned income — a decision has to be made every year whether to increase contribution up to the full 15 per cent.

A decision also has to be made whether to put all that increase into your existing RA, or to take out a new contract for the additional amount.

This raises the questions of how good RA's are as investments, how effective they are likely to be in providing for your retirement, and whether there are better alternatives.

According to a study by Personal Finance newsletter, the actual returns that policy holders have received on conventional (bonus type) contracts has averaged only nine per cent a year over various periods, up to 20 years.

The figures suggest that you need to contribute to an RA for more than 15 years just to achieve a return that keeps up with inflation.

These days linked contracts are more popular than conventional ones, but they have not been going long enough to provide convincing proof that they are better.

What figures I have seen suggest that linked contracts have performed better than bonus-type ones, but only two-thirds as well as an equivalent investment in mutual fund units.

This is not the whole story, because of the large tax benefits you enjoy when contributing to an RA.

Your contributions are fully deductible from gross income up to the 15 per cent limit. This means that if your marginal rate of tax is 40 per cent — a level you reach when your taxable income exceeds R2 167 a month — the Receiver effectively pays 40 per cent of your contribution.

If your marginal rate is 45 per cent, he effectively pays 45 per cent.

Any income earned through investment of your contributions within the retirement annuity fund is free of tax. However, the other side of the coin is that 53 per cent of your contributions has to be invested in 'prescribed assets' paying rates of interest that are usually not even sufficient to keep pace with inflation.

When your contract matures, you can draw up to one-third of your accumulated capital in cash, with up to R60 000 of that amount free of tax, and any surplus taxed on an advantageous basis. The balance of your capital has to be invested to buy you an annuity (pension) for life.

However, the sting in the tail is that that annuity is fully taxable as income in your hands.

To make a comparison between RAs and alternative kinds of investment-for-retirement plans requires many assumptions.

In the typical case I constructed, for a very successful doctor paying the maximum marginal rate of tax (50 per cent), and contributing from age 40 to age 65, he could expect an average annual yield after taking all tax factors into account, of slightly under 20 per cent.

That may sound high, but other kinds of investment have done rather better in recent years, such as shares, mutual funds, ordinary Kruger rands and collectables.

Another thing you should remember about RA's is that one of their major attractions is that you are, at least, about to draw one-third of your capital on maturity as a lump sum, to invest how you wish.

Many doctors signed up for RA schemes because it seemed to them that they could get back all their contributions in tax-free cash, plus part of the Receiver's contributions and part of the tax-free growth as well ... enjoying the pension virtually for nothing.

The danger is — you can no longer be sure that you will be able to draw the full one-third of your capital in cash when you retire, but a much lesser proportion.

The Louw Committee, and the Preservation of Pensions Interests Bill that flowed from it, both established the new concept of a 'protected annuity', or portion of pension benefits that may not be commuted for cash in any circumstances.

In a typical case I have constructed, this would mean that a GP retiring in 1987 on an annuity of R2 000 a month would not, at that point, be able to commute 33,3 per cent of his benefits for cash, but only 17 per cent.

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One of the most attractive alternative options is to have a regular savings plan with a mutual fund.

Depending on your tax position, a mutual fund savings plan started now is likely to outperform an RA scheme, even after allowing for different tax treatment, over a period of plus/minus 20 years.

The explanation for this is that the capital growth of mutual fund units has exceeded that of even the best RA funds by a wide margin over the past ten years or so, and this trend is likely to continue, because mutual funds don't have to put a high proportion of their capital into dud investments — nonperforming fixed-interest stocks.

Even over periods significantly shorter than 20 years, mutual fund savings plans could be more attractive than RAs because, when you retire, you have all your resources available in cash to invest how you wish, instead of having most of them locked up to provide a pension.

My advice is to continue contributing to your RA the amount to which you are committed by your contract, but not to increase that amount. Better to pay tax on your income 'surplus' and invest the balance in growth investments such as mutual fund units, shares, property, Kruger rands or collectables.

As you have probably read in the newspapers, the Bill that would have brought the protected annuity system into effect was withdrawn in November because of resistance by Black workers to some of its other provisions.

The concept seems to have been sufficiently accepted for it to be introduced as part of a revised Bill within the next two or three years.

If your retirement date is ten or more years away, I think you would be wise to assume that you will never see the full one-third of your RA benefits in the form of a lump sum, as you have been counting on, but a lesser proportion ... and plan accordingly.

The first principle of your alternative planning should be to swallow your medicine and pay full tax. At least you are then free to invest the balance in any way you want, without the many restrictions and limitations of an RA contract, and in investments likely to provide major tax benefits as well as high rates of return.□

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Retirement of the General Practitioner

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We as doctors know that the solution lies not in special foods and extra-powerful vitamins. The solution is a PLAN based on an exciting and challenging idea.

You're younger than you think

Ten or thirty years ago you were preparing for the role you play in medicine today. Are you preparing now for the role you will play ten or twenty or thirty years from now?

You cannot start fishing or collecting stamps or restoring furniture and old motor cars or investing your savings in the stock exchange the day after you retire.

Now is the time to make interest and participation in all phases of life a settled habit. Now is the time "to learn what is new is to remain ever young!" (Aeschylus).

Many middle-aged doctors feel like failures when they are not failures at all. They have built air castles of success and fame. They may have seen themselves as renowned neurosurgeons, as rich and powerful surgeons, as reversed professors or microbe hunters swathed in acclaim.

Fortunately we know that the fame that meant so much is in itself no route to happiness; wealth and acclaim have little to do with the inner peace and self-realization. The mature person becomes aware of his own limitations, realistic about the goals he still would like to achieve.

Although we have the assurance of a number of "lekker-aftree-jôppies" after 60, we as doctors must take note of the tremendous boom in adult education. The people who wish to grow mentally after 50, make use of tape-courses, correspondence courses and are even attending universities etc.

According to Vedder et al they fall into four groups:

A They take courses to make them more valuable in their work and make it possible for them to earn more money;

B this group consists of women (doctors' wives too!) who want new skills in home-making;

C they go in for cultural enjoyments — sculpting, painting etc;

D this group study difficult new subjects like law and foreign languages for mental stimulation and continued growth. Some of them even graduate at 70 and start a second career!

(What about giving the M. Prax. Med-another go at 80!).

I do not have to remind you that additional knowledge and qualifications make you less dependent on the so-called sheltered medical employment!

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