It's dangerous to rely on your business to fund your retirement. Here's why

You wouldn't take the risk of gambling your livelihood away – but relying on your business or other assets like your home as your sole retirement income solution isn't much different. Find out why experts suggest a combined approach to secure your financial future.

The state of South African retirement planning

Many South Africans are planning to rely on the sale of their business or home to fund their retirement. A Sanlam Reality survey conducted in conjunction with TaxTim in 2019 suggests that business owners are more intent on drawing lower salaries from their businesses now in order to reap the future benefit of growth so that it can one day be cashed in to fund their retirement.

The survey also suggested that while salaried employees save more towards retirement (16%) than entrepreneurs do (10%), this doesn't necessarily mean they earn more. Other indicators in the survey, like medical aid contributions, showed that on average, they were equally financially stable. This points to the likelihood that discretionary income that could be invested in a secure retirement solution is instead reinvested into the business, in the hope that it will one day pay off by funding their retirement.

The problem with the plan

It lacks portfolio diversification

As Suzanne Pope, a Business Development Manager at Glacier by Sanlam, says, relying only on the sale of a single asset like your house or business to fund your retirement is a dangerous bet to make with yourself. “Whether a business or a house, you’re pegging your retirement value to an asset whose value you potentially do not have control over at the point of your retirement,” says Suzanne. “Meanwhile, markets could plummet and property values could drop; there are so many external factors. If the business crashes or liquidates, the retiree will sit with no capital for retirement and will not be able to retire,” she continues. “Relying solely on these assets is not a viable solution in terms of retirement planning.”

Even if you can sell, you’re not guaranteed your price

Having a solid retirement plan in place, and your house, business or other asset as an additional investment is better, as you’re not dependent on the sale of the asset, says Suzanne. “But ultimately the sale of the asset depends on the market conditions at the time of the sale, and on the buyer. So your property is only the value of what somebody is prepared to pay for it.”

It isn’t tax-efficient

If you’ve left an employer to start your own business, it could be tempting to cash in your accumulated provident or pension fund for a cash injection to your new project. However, the tax tables won’t work in your favour. “What we see is people under the age of 55 exiting an employment contract and they take their retirement savings,” says Suzanne. “Those are retirement savings that you are now paying tax on at a withdrawal tax rate, which is not as generous as your retirement tax tables.”

Further down the line, if you’re relying on your business to fund your retirement, there are further tax implications:

1. “You will not receive the annual tax deductions you could’ve received for your own contributions into an RA (Retirement Annuity).”
2. The sale of your business will be subject to capital gains tax (CGT). “It’s important to factor in this tax, which you’ll have to pay off the top of the capital value that you receive from the asset,” notes Suzanne.

You may not even be able to access your capital

“If you’re in partnership with other parties, you may assume that they are also going to want to sell the business at the time you’re planning to cash in, and that you’ll be able to unlock the capital that you perceive is going to fund your retirement,” says Suzanne. This is a recipe for disappointment – and a sticky financial situation.

The value of partnering with a financial adviser

Running a business means that you need an expert by your side to help take care of your personal financial decisions. Your business can hold plenty of financial and personal value to you, but recognising that your retirement needs and your business's needs are separate is vital to a functional retirement plan. A financial adviser can assist in identifying the risks that could derail your retirement plan, and formulating a disciplined strategy that protects you, your family and your business.

Retirement solutions right for you

"A financial adviser can help you set up a retirement annuity fund membership in your name, funded by your business so that there's a more disciplined approach," says Suzanne. "The business would contribute on your behalf and pay the premium for you."

Alternatively, in the case of a larger corporate, a group benefit scheme could be an option. "Depending on the size of the business and the number of employees and contribution, you can set up an employee benefit scheme like a pension benefit scheme and risk cover for you and your employees," explains Suzanne. She points out that the retirement annuity fund route could be preferable in some cases though, because the business can simply stop contributing if a member or owner leaves, and the business owner can take over the debit order. The tax benefits of a retirement annuity fund also make it an appealing option in comparison to relying solely on the sale of a business at retirement.

In summary, relying on proper retirement solutions for your income plan means your savings are more tax efficient.

Retirement tax tables will apply to any cash that is paid out into your bank account when retiring from the retirement solution. This can be more tax efficient than possible capital gains tax liabilities on the sale of an asset. "And the growth is tax-free within the retirement solution," says Suzanne.

Please consult with a financial adviser before you take any action regarding your savings and investments. This article does not constitute financial advice.

Glacier Financial Solutions (Pty) Ltd and Sanlam Life Insurance Ltd are licensed financial services providers.

This document is intended for use by clients, alongside their financial intermediaries. The information in this document is provided for information purposes only and should not be construed as the rendering of advice to clients. Although we have taken reasonable steps to ensure the accuracy of the information, neither Sanlam nor any of its subsidiaries accept any liability whatsoever for any direct, indirect or consequential loss arising from the use of, or reliance in any manner on the information provided in this document. For professional advice, please speak to your financial intermediary.

Glacier Financial Solutions (Pty) Ltd.

A member of the Sanlam Group
Private Bag X5 | Tyger Valley 7536 | Email client.services@glacier.co.za | Tel +27 21 917 9002 / 0860 452 364 | Fax +27 21 947 9210 | Web www.glacier.co.za | Reg No 1999/025360/07
Licensed Financial Services Provider | Glacier Financial Solutions (Pty) Ltd. is also a Licensed Discretionary Financial Services Provider FSP 770, trading as Glacier Invest | Sanlam Multi-Manager International (Pty) Ltd. | A member of the Sanlam Group

Private Bag X8 | Tyger Valley 7536 | Tel +27 21 950 2600 | Fax +27 21 950 2126 | Web www.smmi.com *|*Reg No 2002/030939/07
Licensed Discretionary Financial Services Provider, acting as Juristic Representative under the Glacier Financial Solutions FSP 770
Glacier International is a division of Sanlam Life Insurance Limited
Sanlam Life Insurance Ltd. | Email life@sanlam.co.za | Tel + 27 21 916 5000 / 0860 726 526 | Fax +27 21 947 9440
Reg No 1998/021121/06 | Licensed Financial Services Provider