Retirement Tax Reform
Enhancing your retirement benefits, securing your future
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Introduction

Government’s retirement tax reforms are aimed at promoting a culture of savings and ensuring that retirement fund members have better protection and enough money to retire comfortably. These reforms include enhanced tax relief on contributions to retirement funds, an alignment of different types of retirement funds as well as greater portability between retirement funds.

These tax changes have been introduced by amendments to the Income Tax Act and will come into effect on 1 March 2016. This date is generally referred to as “T-day”. Only contributions made and RETIREMENT benefits taken after T-day will be affected by the retirement reforms. Government has not yet made changes with regards to the preservation of funds when changing jobs so withdrawal benefits prior to retirement are not affected by the latest reforms.

It is essential to understand the nature and extent of these reforms in order to dispel any myths and misperceptions. The status of retirement funds and the security of retirement benefits remains paramount. The Minister of Finance on 4 September 2014, in his Parliamentary Statement on Retirement Reforms and Rumours, is quoted as follows “… assure all members of retirement funds that their pension and provident funds are safe, and there is no need to resign from their jobs and cash in their pension and provident funds.”

What is retirement tax reform?

Retirement tax reform is a process whereby Government, through policies and legislation, seeks to:
• Encourage employee-members of retirement funds to save and provide adequately for retirement
• Encourage employers to structure retirement saving plans for their employees as part of the employment contract
• Ensure that members of retirement funds receive good value for money for their retirement savings and are treated fairly
• Improve standards of retirement fund governance

How will retirement tax reform benefit the average South African?

• South Africans will be encouraged to save (more)
• Members of provident funds will now be able to claim a tax deduction on their contributions in the same way as members of pension and retirement annuity funds.
• Tax-free transfers of savings between different retirement funds will be allowed
• Most South Africans will be able to claim a higher tax deduction for their retirement fund contributions.
What is meant by T-day?

T-day is 1 March 2016 – when the retirement reform tax changes come into effect

- Majority of South Africans today will not be able to retire and still maintain the lifestyle that they currently enjoy
- Government’s intention is to encourage a culture of savings
- The T-day changes primarily affect your contributions to RETIREMENT and access to your benefit at RETIREMENT. They do NOT affect your benefits on WITHDRAWAL

These retirement tax reforms are positive steps to protect members and enhance retirement benefits. Liberty supports these changes.

The retirement tax reforms can be broken down into five major changes:
1. Deductibility of retirement fund contributions
2. Alignment of pension, provident and retirement annuity funds
3. Portability of funds
4. Commutation of benefits

DEDUCTIBILITY OF CONTRIBUTIONS

There are substantial changes to the tax deductibility of retirement fund contributions for both employees and employers

- The tax deduction you can claim for your retirement fund contribution has been increased, subject to an annual cap
- Even though employer contributions will now be treated as fringe benefits, employees can automatically ‘deduct’ both their contribution and their employer’s contribution against the value of that fringe benefit
- Special consideration must be given to Defined Benefit and Hybrid Funds, which have additional obligations in terms of the calculation of the value of the fringe benefit on the contributions

WHAT IS CHANGING?

From T-day the following four important changes will affect all employers, retirement fund members and retirement funds:

1. Employer contributions will be treated as **fringe benefits in the hands of employees**.
2. The **deductible limits** for employee contributions will change.
3. Non-deductible contributions will **roll-over** to the employee’s next tax year.
4. Employer contributions to all retirement funds will be **fully deductible in the hands of the employer**.


## Deductibility of Retirement Fund Contributions

<table>
<thead>
<tr>
<th>Fund Type</th>
<th>Current Position</th>
<th>Changes Effective from T-day</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Separate deduction for each retirement fund contribution</td>
<td>Combined deduction for all retirement fund contributions</td>
</tr>
<tr>
<td>Retirement Annuity</td>
<td>The greater of:</td>
<td>Member:</td>
</tr>
<tr>
<td></td>
<td>15% of non-retirement funding income Or</td>
<td>• Any contributions made by an employer will be taxed as a fringe benefit in the hands of the employee-member</td>
</tr>
<tr>
<td></td>
<td>R3 500 minus deductible pension fund contributions Or</td>
<td>• Members can claim a corresponding deduction of up to 27.5% of the greater of remuneration or taxable income, subject to an annual monetary cap of R350 000</td>
</tr>
<tr>
<td>Pension Fund</td>
<td>Member tax deduction:</td>
<td>• Members will be able to deduct both their and the employer’s contributions up to this limit</td>
</tr>
<tr>
<td></td>
<td>The greater of:</td>
<td>Employer:</td>
</tr>
<tr>
<td></td>
<td>7.5% of retirement funding income or</td>
<td>• Unlimited tax deduction</td>
</tr>
<tr>
<td></td>
<td>R1 750</td>
<td>• Employer contributions treated as fringe benefits in employee’s hands and deemed to be employee contributions</td>
</tr>
<tr>
<td>Provident Fund</td>
<td>Employer tax deduction:</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Up to 20% of approved remuneration</td>
<td></td>
</tr>
</tbody>
</table>

### How Will This Affect Employees From T-Day?

- Any contributions made by an employer to an approved South African retirement fund for the benefit of an employee-member will be treated as a fringe benefit in the hands of the employee-member.
- The value of the fringe benefit for tax purposes for a defined contribution fund will be the value of the employer’s contribution but in the case of a defined benefit fund will be determined through a special formula provided in the Income Tax Act.
- Any contributions made by an employer for the benefit of an employee-member will be deemed to have been made by the employee, thereby being deductible in the hands of the employee.
- Employee-members will be able to claim a corresponding ‘deduction’ of both their and their employer’s contributions to a pension, provident or retirement annuity fund up to the revised limits (27.5% of their ‘remuneration’ or ‘taxable income’, whichever is greater, capped at R350 000 pa).
- Fringe benefits tax will only be payable to the extent that the value of the employer contributions exceed the new deductible limits as illustrated in the examples provided.
- If in a particular year you contribute more than 27.5% of your ‘remuneration’ or ‘taxable income’ or more than R350 000, SARS will automatically roll over this ‘excess’ Rand value amount (non-deductible contributions) to the next tax year and you can claim a deduction in that following year.
- The next tax year’s deductible limits will be applied afresh.
- At retirement, the Rand value of the non-deductible contributions that are left will be applied to the lump sum and/or annuity benefits as a tax-exempt amount. In other words a portion of the lump sum or annuity to the value of the non-deductible contributions will be exempt from tax.
- If the employee contributes to a retirement annuity in his/her personal capacity (i.e. not through his/her employer), at the end of the tax year his/her contribution certificate will be submitted to SARS and the overall tax position calculated. At this point the employee may be refunded tax if total contributions towards retirement funds are below the deductible limits.

### How Will This Affect Employers From T-Day?

- Employers will now be able to deduct all retirement fund contributions in full – the limit of 20% per annum of ‘approved remuneration’ falls away.
- As noted for employees, the employer contributions will now be treated as a fringe benefit in the hands of employees on a monthly basis.
- This will have payroll, salary slip and tax certificate implications for employers.
- Although an employer must raise a fringe benefit in the payroll, the employer must give the employee a corresponding ‘deduction’ i.e. reduce the value of remuneration (inclusive of the fringe benefit) by the value of contribution that the employer and employee have made to a pension, provident fund or retirement annuity fund, limited to the employee’s tax deductible limits.
• Any contribution that the employer has made to a retirement fund is seen as a deemed employee contribution.
• In the case where the employer has not made the contributions to a retirement annuity, the employer has the option to reduce the value of remuneration once proof of payment has been provided to the employer. The deduction for contributions to a retirement annuity is subject again to the employee's tax deductible limit.
• Tax certificates - IRP5's/IT3(a)'s – issued by employers should reflect the fringe benefit values as well as the corresponding ‘deduction’ values of the employer/employee contributions. SARS will finalise the codes to be used during the next few months.
• The fringe benefit calculation as well as the corresponding retirement fund deduction (subject to deductible limits) must be applied monthly in the payroll.

ILLUSTRATIVE EXAMPLES – Deductibility of retirement fund contributions

1. Basic employer calculation
• Employee A is a member of a provident fund.
• Employee A has an annual total cost to company (remuneration) of R300 which includes all fringe benefits. Employee A has a basic salary of R180 000.
• In accordance with the fund’s rules, the employer contribution represents 20% of Employee A’s basic salary, and Employee A’s contribution represents 5% of the basic salary.
• In monetary terms, the employer makes a contribution of R36 000 (20% of R180 000 paid as R3 000 per month) to the fund in the name of Employee A, whilst Employee A makes a contribution of R9 000 (5% of R180 000 paid as R750 per month) to the fund.

<table>
<thead>
<tr>
<th>Yearly contributions made to the provident fund</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Employer (R180 000*20%)</td>
<td>R 36 000</td>
</tr>
<tr>
<td>Employee A (R180 000*5%)</td>
<td>R 9 000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>R 45 000</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Contributions deductible for tax purposes – Employee</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deemed employee contributions for the year</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>R 45 000</td>
</tr>
<tr>
<td>Limited to the lesser of:</td>
</tr>
<tr>
<td>a. 27.5% of remuneration (R300 000) or</td>
</tr>
<tr>
<td>b. R350 000 (annual cap)</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>R 82 500</td>
</tr>
<tr>
<td>R 350 000</td>
</tr>
<tr>
<td>Allowable deduction against income</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>R 45 000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Contributions deductible for tax purposes – Employer</th>
</tr>
</thead>
<tbody>
<tr>
<td>Contributions for the year</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>R 36 000</td>
</tr>
</tbody>
</table>

Result:
• Employee A will have a fringe benefit of R36 000 reflected on his/her IRP5 and payslip.
• However, for purposes of determining potential contribution deductions, Employee A will be deemed to have contributed the R36 000 (employer contributions) PLUS his/her own contributions (R9 000) to the provident fund, totalling R45 000.
• Employee A will be entitled to a deduction of R45 000 against income earned, thereby off-setting the fringe benefit amount and placing A in a tax neutral position, as:
  • Neither the percentage limit (27.5% of R300 000 = R82 500) or
  • the monetary limit of R350 000, has been exceeded
• Employee A will consequently not be liable for any fringe benefit tax on the employer retirement fund contribution of R36 000 i.e. (R36 000- R45 000= -R9000) and a R9000 net deduction will be applied against his income during the course of the tax year.

2. Contributions in excess of deductible limits (percentage limit 27.5%)
• Employee B is a member of a provident fund.
• Employee B has an annual total cost to company (remuneration) of R190 000, which includes all fringe benefits. Employee B has a basic salary of R180 000.
• According to the fund’s rules, the employer contribution represents 20% of Employee B’s basic salary, and Employee B’s contribution represents 10% of Employee B’s basic salary.
• In monetary terms, the employer makes a contribution of R36 000 (20% of R180 000 paid as R3 000 per month) to the fund in the name of Employee B, whilst Employee B makes a contribution of R18 000 (10% of R180 000 paid as R1500 per month) to the fund.
Yearly contributions made to the provident fund

Employer (R180 000*20%)  
R 36 000

Employee B (R180 000*10%)  
R 18 000

Total  
R 54 000

Contributions deductible for tax purposes – Employee

Deemed employee contributions for the year  
R 45 000

Limited to the LESSER OF:

a. 27.5% of remuneration (R 190,000) or  
R 52 250

b. R 350 000  
R 350 000

Allowable deduction against income  
R 52 250

Contributions deductible for tax purposes – Employer

Contributions for the year  
R 36 000

Result:

• Employee B will have a fringe benefit of R36 000 reflected on his/her IRP5.

• However, for purposes of determining potential contributions deductions, Employee B will be deemed to have contributed the R36 000 (employer contributions) PLUS his/her own contributions (R18 000) to the provident fund, totalling R54 000. Employee B will be entitled to a deduction against his/her income. The total deduction against his/her income will amount to R52 250 (27.5% * R 190 000).

• Employee B will consequently not be liable for any fringe benefits tax on the employer retirement fund contribution of R36 000 i.e. R (36 000 - R52 250 = R16 250) and a R16 250 net deduction will be applied against his/her income during the tax year.

• On assessment, Employee B's total deductible contributions to his retirement funds will be determined. As his deduction will be limited to R52 250, the excess contribution of R1 750 (R54 000 - R52 250) will be rolled over to Employee B's following year of assessment.

3. Contributions in excess of deductible limits (R350 000 limit)

• Employee C is a member of a pension fund.

• Employee C has an annual total cost to company (remuneration) of R3 000 000 which includes all fringe benefits. Employee C has a basic salary of R2 000 000.

• According to the fund's rules, the employer contribution represents 10% of Employee C's basic salary, and Employee C's contribution represents 20% of Employee C's basic salary.

• In monetary terms, the employer makes a contribution of R200 000 (10% of R2 000 000 paid as R16 666.67 per month) to the fund in the name of Employee C, whilst Employee C makes a contribution of R400 000 (20% of R2 000 000 paid as R33 333.33 per month) to the fund.

Yearly contributions made to the provident fund

Employer (R2 000 000*10%)  
R 200 000

Employee C (R2 000 000*20%)  
R 400 000

Total  
R 600 000

Contributions deductible for tax purposes – Employee

Deemed employee contributions for the year  
R 600 000

Limited to the LESSER OF:

a. 27.5% of remuneration (R 3,000,000) or  
R 825 000

b. R 350 000  
R 350 000

Allowable deduction against income  
R 350 000

Contributions deductible for tax purposes – Employer

Contributions for the year  
R 200 000

Result:

• Employee C will have a fringe benefit of R200 000 reflected on his/her IRP5.

• However, for purposes of determining potential contribution deductions, Employee C will be deemed to have contributed the R200 000 (employer contributions) PLUS his/her own contributions (R400 000) to the provident fund, totalling R600 000. Employee C will be entitled to a deduction against his/her income. The total deduction against his/her income will amount to R350 000.

• Employee C will consequently not be liable for any fringe benefits tax on the employer retirement fund contribution of R200 000 i.e. R (200 000 - R350 000 = -R150 000) and a R150 000 net deduction will be applied against his/her income during the tax year.

• On assessment, Employee C's own deductible contributions to his/her retirement funds will be determined. As his/her deduction will be limited to R350 000, the excess contribution of R250 000 (R600 000 - R350 000) will be rolled over to Employee C's following year of assessment.
WHAT SHOULD EMPLOYERS BE CONSIDERING?

Employers with their payroll administrators should consider the following changes:

Payrolls:

- Employer contributions should be reflected as fringe benefits on a monthly basis;
- An allowable deduction from ‘remuneration’ should be calculated on a monthly basis;
- The allowable deduction comprises a deduction for the employer and employee contributions subject to the new deductible limits;

Tax certificates (IRP5’s/IT3(a)’s):

- Tax certificates will no longer refer to ‘retirement funding income’ or ‘non-retirement funding income’ as the new deductible limits based on ‘remuneration’ and/or ‘taxable income’. Tax certificates must reflect employer contributions as fringe benefits and incorporate the deductions as a separate field.
- New fringe benefit and deduction codes will be released by SARS.
- Employers must consider engaging with their respective payroll administrators and aim to simplify contributions structures.
- Salary structures may need to be reviewed to determine if there is an impact and whether restructuring is required. This may result in individual employee contracts having to be reviewed; any change in contribution structure will require a change to the special rules of retirement funds in which the employees participate.
- Possible amendment to company policies relating to employee benefits
- Proper communication and information sharing with employees
- Employers who are currently not contributing towards retirement funds on behalf of their employees, should consider incorporating retirement savings into existing salary structures.

WHAT SHOULD EMPLOYEES/MEMBERS BE CONSIDERING?

- Employees together with their employers should reconsider the rate at which they contribute towards retirement funds:
  - Some employees can choose their contributions to the retirement fund, while others may not. This agreement is usually set out in the employment contract and the special rules of the retirement fund.
  - Where employees have a choice, they have to understand what percentage of salary they should select in order to ensure they are in the same or better financial position.
  - Where employees do not have a choice, they should understand how their contributions are changing, if at all.
  - Should the employer and employee contribute over the tax deductible limit, employees will not receive a tax deduction on their excess contributions and may have to pay fringe benefits tax on the excess. Any non-deductible amounts may however be rolled over to the next year of assessment.

OUR view

If you have a choice and are able to, consider increasing your contributions if you are under the new deductible limits in order to benefit from the greater tax relief offered by the tax changes.

Even if your retirement contributions exceed the deductible limits, it is important to remember that retirement savings remain a tax efficient vehicle because non-deductible contributions are rolled over to following years, and the growth within the retirement fund is not taxed.
WHAT SHOULDN’T TRUSTEES OR BOARDS OF MANAGEMENT OF RETIREMENT FUNDS CONSIDER?

The rules of retirement funds should be reviewed to ensure that contribution structures are aligned with the new deductible limits, this revision may result in a rule amendment or revised special rules.

Steps SARS still needs to implement

When a retirement fund member takes a lump sum benefit or annuity from the retirement fund, SARS will apply the balance of the non-deductible contributions at that time against the lump sum withdrawal benefit or annuity. This tax relief will be provided on lump sums at the time of the tax directive application and in the case of annuities on assessment only.

ALIGNMENT OF PENSION, PROVIDENT AND RETIREMENT ANNUITY FUNDS

From 1 March 2016 (‘T-day’) the retirement benefits paid from provident funds will be aligned with pension and retirement annuity funds

What are ”VESTED BENEFITS” in a PROVIDENT FUND?

One major change taking place on T-day affects the options available to a member who retires from a provident fund or provident preservation fund. You are able to take your full retirement benefit as a cash lump sum.

The fund benefits (retirement savings) of all provident fund and preservation fund which have accumulated up to T-day, plus the future growth on this fund value will be regarded as VESTED BENEFITS.

If you retire from your provident fund or provident preservation fund after T-day the following will apply;

• All VESTED BENEFITS (i.e fund values (retirement savings) already accumulated in your provident fund UP TO T-day) may paid out as a cash lump benefit at retirement.
• All contributions and growth which accumulate ON OR AFTER T-day will have to be annuitised – what does this mean?
• You will only be able to take out 1/3 of the benefits accumulated after T-day as a cash lump sum payment. The remaining 2/3 must be used to buy an annuity that will pay you a monthly pension or annuity.

Members aged 55 years on T-day have the right to additional vested benefits.

• This means if you are 55 years or older on T-day AND you remain a member of the same provident fund, you will not be affected by these legislative changes. You may still receive your entire retirement benefit as a cash lump sum at retirement.
• If you transfer out of your provident fund to another retirement fund after T-day, in terms of the current wording of the legislation, you will only be entitled to your fund value (retirement savings) at the time of transfer (plus growth) as a cash lump sum on retirement from that subsequent retirement fund.

Vested benefits retain their nature and will follow the provident fund or provident preservation fund member, even if the member transfers to another fund, e.g. to preservation, pension, retirement annuity and unclaimed benefit funds. Their vested benefits will remain in place until they ultimately retire from the subsequent retirement fund.
**SUMMARY OF CHANGES RELATING TO THE ALIGNMENT OF RETIREMENT BENEFITS IN PENSION, PROVIDENT, AND RETIREMENT ANNUITY FUNDS**

<table>
<thead>
<tr>
<th>Fund Type</th>
<th>Current position of accessing benefits at retirement</th>
<th>Accessing retirement benefits after T-day</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retirement Annuity</td>
<td>1/3 cash lump sum</td>
<td>No change</td>
</tr>
<tr>
<td></td>
<td>2/3 pension annuity</td>
<td></td>
</tr>
<tr>
<td>Pension Fund</td>
<td>1/3 cash lump sum</td>
<td>No change</td>
</tr>
<tr>
<td></td>
<td>2/3 pension annuity</td>
<td></td>
</tr>
<tr>
<td>Provident Fund</td>
<td>Retirement benefits may be taken in full as a lump sum</td>
<td>Vested benefits</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Benefits accruing up to T-day plus growth can be taken as a cash lump sum</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Non vested benefits</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Contributions plus growth accumulated after T-day*</td>
</tr>
<tr>
<td></td>
<td></td>
<td>1/3 cash lump sum</td>
</tr>
<tr>
<td></td>
<td></td>
<td>2/3 mandatory to purchase an annuity with the provident fund retirement benefit</td>
</tr>
<tr>
<td></td>
<td></td>
<td>*special rules for members 55 years and older on T-day</td>
</tr>
</tbody>
</table>

**POSITION BEFORE AND AFTER T-DAY FOR RETIREMENT BENEFIT PAYOUTS IN PROVIDENT FUNDS**

<table>
<thead>
<tr>
<th>Member who was younger than 55 years on T-day</th>
<th>Pre- T-day portion of share of fund</th>
<th>Post- T-day portion of share of fund</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Fund balances as at T-day, plus any future growth on such balances may be taken as a cash lump sum</td>
<td>Up to 1/3 of the benefit may be taken as a lump sum</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Member who was older than 55 years on T-day</th>
<th>Pre- T-day portion of share of fund</th>
<th>Post- T-day portion of share of fund</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Fund balances as at T-day, plus any growth from that date on such balances may be taken as a cash lump sum</td>
<td>Members will also be able to take their post-T-day retirement fund values as a cash lump sum on retirement, provided they remain within the same provident fund</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Should a member transfer to another fund contributions to such fund will not be protected</td>
</tr>
</tbody>
</table>

**WHAT SHOULD PROVIDENT FUND MEMBERS BE CONSIDERING?**

- There are different options at retirement for provident fund members and these changes must be taken into account for your retirement planning.
- Provident fund members who are 55 years or older on T-day and remain in the same provident fund will not be affected by these legislative changes. These members may still receive their entire retirement benefit as a cash lump sum at retirement.
- If a member transfers to another retirement fund, their vested benefits (pre T-day fund value/ retirement savings plus growth) will retain their nature and transfer with the member until they eventually retire and may be accessed as a cash lump sum at retirement.
- Divorce orders, other permissible section 37D deductions such as maintenance orders and housing loans, withdrawals and transfers prior to retirement will reduce a member’s share of fund and consequently a member’s vested benefits.
- The T-day changes DO NOT prevent pension and provident fund members from withdrawing their benefits PRIOR to retirement as a full cash lump sum. This means if you resign or are dismissed or retrenched by your Employer you may still access your entire retirement savings as a cash lump sum from the retirement fund.

**WHAT SHOULD EMPLOYERS BE CONSIDERING?**

- Employers have to understand the changes impacting provident funds, especially if they have employees who are 55 years or older as at T-day.
- Where an employer participates in both a pension and provident fund or a hybrid arrangement, they should consider whether to consolidate into one retirement fund, and how this affects the vested benefits of employees who are 55 years or older and are members of a provident fund.
- Any section 14 transfers after T-day will have to indicate the provident fund members’ pre and post T-day fund values (retirement savings).
ILLUSTRATIVE EXAMPLES – Alignment of pension, provident and retirement annuity funds

PLEASE NOTE: For simplicity these examples assume no capital growth on fund values, however, all capital growth on funds accumulated by T-day will also be included in the amount the member is allowed to take as a cash lump sum

1. Provident fund member who is **55 years** on T-day and remains in the fund until retirement
   - Member A is a member of a provident fund and is 55 years on T-day.
   - On T-day Member A has accumulated R350 000 as a fund value (retirement savings).
   - Between T-day and retirement on 1 March 2020, Member A has contributed a further R70 020 towards retirement savings in the same provident fund.
   - At retirement on 1 March 2020 the fund value is R420 020 (made up of R350 000 plus R70 020).
   - At retirement, Member A will be entitled to take the entire provident fund value of R420 020 as a cash lump sum retirement benefit, because of the vested benefits applicable to provident fund members 55 years and older on T-day

<table>
<thead>
<tr>
<th>Provident fund member 55 or older on T-day</th>
<th>Fund value at T-day</th>
<th>Contributions after T-day</th>
<th>Fund value on retirement 1 March 2020</th>
<th>Amount entitled to be taken as a cash lump sum on retirement</th>
<th>Amount to purchase an annuity</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>R350 000</td>
<td>R70 020</td>
<td>R420 020</td>
<td>R420 020</td>
<td>Not applicable</td>
</tr>
</tbody>
</table>

2. Provident fund member who is **55 years** on T-day and transfers to another retirement fund before retiring
   - Member B is 55 years on T-day and is a member of ABC provident fund.
   - On T-day Member B has accumulated R350 000 as a fund value (retirement savings).
   - Member B transfers to XYZ provident fund on 1 March 2020.
   - Between T-day and 1 March 2020, Member B has contributed a further R150 000 towards retirement savings in ABC provident fund.
   - Between 1 March 2020 and retirement on 1 March 2025, Member has contributed R300 000 towards retirement savings in XYZ provident fund.
   - At retirement on 1 March 2025 member B total retirement savings are R800 000 (made up of R350 000 plus R150 000 plus a further R300 000).
   - At retirement, member B will be entitled to take an amount of R 600 000 as a cash lump sum (R350 000 plus R150 000 contributed to ABC provident fund after T-day plus R100 000 being 1/3 of the fund value of R300 000 accumulated after 1 March 2020) Member B must use the remaining (two-thirds) R200 000 to purchase an annuity/pension

<table>
<thead>
<tr>
<th>Provident fund member 55 or older on 1 March 2015 and transfers to another retirement fund before retiring</th>
<th>Fund value at T-day</th>
<th>Contributions after T-day to ABC Provident Fund</th>
<th>Contributions from 1 March 2020 to XYZ Provident Fund</th>
<th>Fund value on retirement 1 March 2025</th>
<th>Amount entitled to be taken as a cash lump sum on retirement</th>
<th>Amount to purchase an annuity</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>R350 000</td>
<td>R150 000</td>
<td>R300 000</td>
<td>R800 000</td>
<td>R600 000</td>
<td>R200 000</td>
</tr>
</tbody>
</table>

3. A provident fund member who is **younger** than 55 years old on T-day
   - Provident fund member C is 45 years old on T-day
   - Member C has accumulated R237 000 as a fund value (retirement savings) as at T-day.
   - Between T-day and retirement on 1 March 2030 the member has contributed an additional R300 000 towards retirement savings.
   - At retirement on 1 March 2030 the fund value is R 537 000 (made up of the first R237 000 plus future contributions of R300 000).
   - At retirement member C will be entitled to take R337 000 being R237 000 (plus growth) accumulated prior to T-day as well as one-third (R100 000) of the R 300 000 benefit accumulated after T-day, as a cash lump sum benefit, because member C has vested benefits for the fund value accumulated prior to T-day.
   - Member C must use the remaining (two-thirds) R 200 000 to purchase an annuity/pension

<table>
<thead>
<tr>
<th>Provident fund member younger than 55 on T-day</th>
<th>Fund value at T-day</th>
<th>Contributions after T-day</th>
<th>Fund value on retirement 1 March 2030</th>
<th>Amount entitled to be taken as cash lump sum on retirement</th>
<th>Amount to purchase an annuity</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>R237 000</td>
<td>R300 000</td>
<td>R537 000</td>
<td>R337 000</td>
<td>R200 000</td>
</tr>
</tbody>
</table>
PORTABILITY

Portability of retirement savings refers to the transfer of retirement savings between different retirement fund vehicles.

WHAT IS CHANGING?

As a result of the tax harmonisation of retirement funds, tax neutral transfers between different retirement funds will be possible from T-day:

- Transfers between all retirement funds, other than from a retirement annuity fund, will be permitted on a tax neutral basis. This means that transfers from pension to provident funds for instance, will now be allowed without any adverse tax consequence.
- A member in a retirement annuity fund will still only be able to transfer to another retirement annuity fund. The reason for this exception is that a retirement annuity fund has a restriction that no other retirement fund has – a member in this fund can only take a withdrawal before retirement age under very limited circumstances.
- It is important to remember that this change takes place after T-day. Any transfers from pension to provident funds BEFORE this date will NOT be tax neutral.
- This is subject to the fund rules allowing for transfers.

THE FOLLOWING TYPES OF TRANSFERS WILL BE POSSIBLE ON A TAX NEUTRAL BASIS

<table>
<thead>
<tr>
<th>From</th>
<th>To</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pension Fund</td>
<td>Pension Fund</td>
</tr>
<tr>
<td>Pension Preservation Fund</td>
<td>Pension Preservation Fund</td>
</tr>
<tr>
<td>Provident Fund</td>
<td>Provident Fund</td>
</tr>
<tr>
<td>Provident Preservation Fund</td>
<td>Provident Preservation Fund</td>
</tr>
<tr>
<td>Retirement Annuity Fund</td>
<td>Retirement Annuity Fund</td>
</tr>
</tbody>
</table>

COMMUTATION OF BENEFITS

Commutation is the conversion of annuities into a cash lump sum. Members of all retirement funds are allowed to commute a portion of their annuities at retirement (normally up to one third of the retirement benefit).

WHAT IS CHANGING?

- Members of pension funds, pension preservation funds and retirement annuities can convert (commute) up to one third of their retirement benefit into a lump sum at retirement. They have to purchase an annuity with at least two thirds of the retirement benefit.
- There is however a minimum Rand threshold (commutation threshold) at which are not required to purchase an annuity. These retirement fund members will be able to convert (commute) their entire retirement benefit and take it out as a cash lump sum. The current minimum Rand threshold of R75 000 will increase to R247 500 on T-day.
- If the retirement benefit of a member is R247 500 or less, the member will be allowed to take their whole benefit as a cash lump sum; he/she will not be required to buy a pension with at least two thirds of his benefit. This will apply to all types of retirement funds.
- In the case where a person receives a monthly annuity payment, that person may be allowed to convert (commute) their annuity to a cash lump sum payment if the total value of their annuity is R247 500. This is still subject to confirmation by SARS. As provident fund benefits accumulating after T-day will also be subject to annuitisation, the minimum Rand threshold will also apply to these benefits. Members of provident funds will therefore also be able to commute their post T-day benefits if they fall below R247 500.

ILLUSTRATIVE EXAMPLE – commutation of retirement benefit of a provident fund member

Provident fund member who is younger than 55 years old on T-day with new contributions below the de minimis threshold amount of R247 500
- Provident fund Member D is 52 years old on T-day
- On T-day Member D has accumulated R400 000 as a fund value (retirement savings).
- Between T-day and retirement on 1 March 2025, Member D has contributed an additional R145 000 towards retirement savings.
- At retirement on 1 March 2025 the fund value is R545 000 (made up of the first R400 000 plus R145 000 accumulated after T-day)
- At retirement Member D will be entitled to her entire retirement savings of R545 000 as a cash lump sum at retirement (i.e. R400 000 plus R145 000). This because Member D is not affected by the annuitisation requirement because the amount accumulated after T-day (i.e. “new contributions”) is less than the R 247 500 de minimis threshold amount.

| Provident fund member younger than 55 on 1 March 2015 whose future contributions are less than R247 500 |
|--------------------------------------------------|--------------------------------------------------|---------------------------------|----------------------------------|
| Fund value at T-day                              | Contributions after 1 March 2015                  | Fund value on retirement 1 March 2025 | Amount entitled to be taken as a cash lump sum on retirement |
| Amount to purchase an annuity                    |                                                  |                                 |                                      |
SUMMARY OF CHANGES AND CONSIDERATIONS

SUMMARY FOR TRUSTEES OF RETIREMENT FUNDS

a. General

• Contribution structures may be revised due to the new deductibility requirements.
• Separate accounts will have to be maintained for all retirement funds in order to separate pre-T-day fund balances and post T-day fund balances. The reason why all retirement funds will need to maintain these separate accounts is that they have to factor in transfers from provident funds or provident preservation funds. As transfers from provident funds may include both pre and post T-day balances, the recipient retirement fund will need to ensure that it also identifies those balances.
• Consideration may need to be given to separate accounts for members older than 55 at T-day.
• The impact on section 14 transfers; especially in respect of provident fund members whose transfer value must provide the splits of pre and post T-day balances.
• General member communication and information material provided to members, including member benefit statements
• Special consideration must be given to Defined Benefit and Hybrid Funds, who have additional obligations in terms of the calculation of fringe benefit on the contributions.
• Whether or not to consolidate pension and provident funds as well as preservation funds where they operate as a hybrid arrangements

b. Impact of retirement tax reform on retirement fund rules

• Revising existing rules, in order to be compliant with legislation.
• Consolidating existing rules, in the event of there being multiple rule amendments.
• Consolidating main and/or special rules as and when necessary.
• Submitting rules to the Financial Services Board (FSB), to obtain registration and approval.
• Possible rules that may require revision:
  • The definition of contributions
  • The definition “pensionable salary” or “fund salary”
  • The definition of “insured salary”
  • Restrictions on transfers to and from retirement funds
  • The retirement benefit provisions, including for provident fund members who are 55 years or older on T-day
  • The withdrawal benefit provisions
  • Commutation provisions

c. Impact of retirement tax reform on Defined Benefit Funds

Defined Benefit Fund Contributions

The changes introduced by the Income Tax Act regard the valuation of DB contributions by the employer as a fringe benefit in the hands of the employee. DB funds offer retirement benefits that are calculated according to the rules of the fund. As a result, the value of the contributions of the fund may not be an accurate reflection of the benefits that may be received by the fund member.

For example, if the fund is in financial difficulty and the employer needs to make additional contributions to meet the expected liabilities, it may be unfair to tax members of the fund on those contributions as if they were a fringe benefit if there is no associated increase in benefits.

In order to avoid discrepancies of this nature and to improve fairness in relation to the tax treatment of contributions to defined contribution (DC) funds, regulations to the Income Tax Act introduces a formula in order to approximate the increase in retirement benefits within a defined benefit fund. The formula calculates a notional employer contribution to the defined benefit fund based on the estimated increase in retirement benefits.

The notional employer contribution will be a fringe benefit that is taxable in the hands of the employee and will be included in the
contribution amount to calculate whether the individual is still below the allowable annual deductible limits.

Fund Member Category

The regulations further introduce the concept of a Fund Member Category (FMC). A FMC is a group of members of a fund whose entitlement to receive benefits and the value of those benefits when they are received, are determined by the same rules. In addition, the contributions paid for employees of a FMC will be based on the same proportion of pensionable salary.

The regulations require that the fringe benefit should be calculated separately for each FMC of a fund. This is to ensure that the fringe benefits are calculated across groups of members in the same way as the fund pools contributions and the costs of paying benefits across members.

Contribution Certificates for DB funds

The draft regulations also require each employer who participates in a DB fund to be provided with a Contribution Certificate in relation to its fringe benefit liability. The Contribution Certificate must be provided by the Board (of the fund) to the employer one month before the commencement of the year of fringe benefit assessment. The Board (of the fund) must provide a separate Contribution Certificate for each FMC.

The Income Tax Act introduces Regulations on the information that must be contained in the Contribution Certificate. These requirements are extensive and include for example:

• Details of the pension fund and year of assessment to which the certificate applies;
• Details of the employer; the different components of the fund – whether they be defined benefit components, defined contribution components; risk benefit components or hybrid elements; and
• The fund member category factor for the applicable fund member category.

The Notional Employer Contribution

To calculate the notional employer contribution to a DB fund (i.e. the fringe benefit), the employer would need to multiply the pensionable salary by the ‘Fund Member Category Factor’ (FMC Factor) that is provided in the Contribution Certificate and subtract the value of any contribution made by the employee.

The fund would be required to calculate the FMC Factor by following the calculation method specified in the Regulations. This requires the fund to separate benefits for which members of the fund are eligible into DB, DC, underpin and risk benefit components. A separate calculation method is specified for each type of component. If a fund offers more than one benefit component of a particular type, a calculation would need to be performed for each benefit component separately and the results aggregated for the FMC Factor.

Contact details

To discuss the impact on Defined Benefit Funds, please contact Michael de Villiers of LCCA:

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SUMMARY OF EMPLOYER CONSIDERATIONS

• The concept of gross retirement funding employment income and gross non-retirement funding employment income will no longer be relevant to determine a member’s deductibility of retirement fund contributions.

• Employers will be able to claim unlimited deductions on their contributions compared to the current limit of 20% of approved remuneration.

• Employers will have to change their payrolls to reflect retirement contributions as fringe benefits and must also determine the corresponding deduction available to employees with reference to new limits.

• Employer payrolls and tax certificates issued by employers for the 2016/2017 tax year will have to be updated to reflect the changes.

• Salary structures may need to be reviewed to see if there is an impact and whether restructuring is required. This may result in individual employee contracts needing to be reviewed and any change in contribution structure will require a change to the special rules.

SUMMARY OF MEMBER (EMPLOYEE) CONSIDERATIONS

• Employer contributions to retirement funds will be reflected as fringe benefits in the hands of employees.

• Employees may deduct up to 27.5% of the greater of remuneration or taxable income in respect of contributions (employer and employee) to pension, provident and retirement annuity funds, subject to an annual cap of R350 000.

• This corresponding deduction will take place monthly on the payroll system. This means that most employees/members will be in a tax neutral position and in some cases, may be in a better tax position.

• It is key to note that fringe benefit tax will only become payable should the value the employer contributions exceed the new deductibility limits.

• Any contribution in excess of the new deductible limits can be rolled over and claimed as a deduction in subsequent tax years.

• Any portion of contributions that are not deducted during the members’ lifetime can be taken out tax-free at retirement- either as part of the retirement fund lump sum or as an exempt portion of an annuity.

• The new deductibility limits effectively entitle members to a bigger deduction.

• The minimum Rand threshold at which you can take your retirement benefit as a full cash lump sum will be increased from R75 000 to R247 500 for all retirement funds.

• Transfers from pension funds to provident funds will be allowed tax-free after T-day.

• Provident Funds Members:
  • All members of provident funds prior to T-day will be entitled to access the ‘balances’ in their fund PLUS growth as lump sums when they exit on retirement. In other words, fund balances as at T-day plus growth will NOT need to be annuitised.
  • Vested benefits of members will be protected when fund balances are transferred to other retirement funds (including preservation funds).
  • Members of provident funds who are older than 55 on T-day will not be subject to mandatory annuitisation at all provided the member remains in the same provident fund.
Contact details

Please visit our website for further information as well as National Treasury website

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