LIFE INVESTMENTS HEALTH **CORPORATE** PROPERTIES ADVICE

Retirement Tax Reform

DB Funds

LIBERTY

Introduction

In recent months much has been published about the impact of the changes to legislation affecting retirement funds as contained in the Financial Services Laws General Amendment Act no 45 of 2013 which mostly became effective 28 February 2014 as well as the Taxation Laws Amendment Act no 31 of 2013 ("TLAA") which becomes effective on 1 March 2015.

This note looks at the proposed regulations in terms of paragraph 12D(5)(a) of the Seventh Schedule to the Income Tax Act, 1962 (Act No. 58 of 1962) released on 10 June 2014. Liberty Corporate Consultants and Actuaries ("LCCA") is well positioned to assist employers and retirement funds to implement the necessary changes to address the requirements of the TLAA as it relates to their employee benefit arrangements which include Defined Benefit (DB) funds.

Given the current status of the TLAA, we have outlined below a high level work flow process to deal with the new requirements of the TLAA for funds/employers.

Defined Benefit Fund Contributions
The proposed changes introduced by the TLAA 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, the Regulations introduce a formula 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 TLAA further introduces 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 TLAA requires 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 Certificate

The Regulations require each employer 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.

Regulations on the information that must be contained in the Contribution Certificate that the fund must provide the employer is also given. 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.

Toolkit for Funds

LCCA has developed a toolkit which will assist employers, consultants, Principal Officers and Trustees with this task. The various component factors making up the Contribution Certificate have been identified, categorised and listed. This toolkit will provide the employer and the fund with a service that meets the requirements of the Regulations including providing the necessary calculations and documents for submission.

Our Proposal

Our proposal for Employers/Funds includes:

- Provision of a generic overview of the various changes introduced by TLAA;
- Discussion of the requirements of the Contribution Certificate;
- Introduction to the toolkit service and its parameters as well as output;
- Analysis of the governance policies to be considered by the Employers/Funds in taking this forward.

Contact details

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