TERENCE TOBIN

Tax law changes affecting retirement funds

As far back as 2011, the South African government announced its intention to introduce extensive retirement fund reforms to promote a culture of retirement savings in South Africa. The intention behind the changes was to standardize different types of retirement funds, help promote a culture of saving and make sure that members' retirement savings are spread throughout their retirement.

Many of the retirement fund reforms that the government proposed have a been implemented, but the requirement for provident fund and provident preservation fund members to take a portion of their benefits as a regular series of taxable payments at retirement ("annuitization") was delayed so that agreement could be reached between the various stakeholders. After many years of consultation, government and various industry bodies have agreed that the annuitisation of provident funds and provident preservation funds, together with other important retirement fund changes will go ahead with effect from **1 March 2021** (also known as "**T-Day**").

Your Financial Adviser will be happy to talk you through the changes and whether they have any impact on your financial freedom.

This letter summarizes the new laws that are effective from T-Day.

1) Annuitization of provident fund and provident preservation fund benefits

Members of pension funds, pension preservation funds and retirement annuity funds ("RAs") have always been required to "annuitize" a portion of their retirement benefits. Members of provident funds and provident preservation funds on the other hand have always been able to take the full value of their retirement benefits as taxable cash lump sums. The bottom line is that from 1 March 2021, (aka, T-Day) members of provident funds, or provident preservation funds, will also be legally obliged to "annuitize" their benefits at retirement.

Essentially, to annuitize funds means taking all or a portion of your retirement fund benefits as a regular series of taxable payments ("annuity income") as opposed to taking it all as a taxable cash lump sum.

From T-Day, the retirement benefits paid from provident funds and provident preservation funds will be aligned to the retirement benefits paid from pension funds, pension preservation funds and RAs. This means that members of provident funds and provident preservation funds will be required to "annuitize" a portion of their benefits at retirement i.e., they will be required to take at least two-thirds of their benefits as "annuity income" when they retire from the fund.

Vested and Non-Vested Benefits

- Existing members of provident funds and provident preservation funds have already accumulated benefits in their funds prior to T-Day with the expectation of receiving those benefits as taxable cash lump sums at retirement. In recognition of that expectation, existing provident fund and provident preservation fund members will have 'vested rights' in those benefits, meaning they can take those benefits plus fund returns on those benefits after T-Day as a taxable cash lump sum when they retire.

- The benefits accumulated by existing provident fund and provident preservation fund members up to T-Day (plus future fund returns on those contributions after T-Day) are referred to as 'Vested Benefits'. Contributions made to provident funds after T-Day as well as fund returns/growth on those contributions are referred to as 'Non-Vested Benefits' and will be subject to annuitization. Members are fully entitled to both their Vested Benefits and Non-Vested Benefits at retirement as both these types of benefits still form part of the member's share of fund. It is only the way they are entitled to receive those benefits that will change i.e., Vested Benefits can be taken as a taxable cash lump sum whereas Non-Vested Benefits are subject to annuitization.

Members who are younger or older than 55 on T-day

The extent of the vested rights of existing members of provident and provident preservation funds will depend on whether they have attained the age of 55 (or older) on T-Day:

- Existing members of provident funds and provident preservation funds who are **younger than 55 years on T-Day** will be required to take an annuity with a portion of their benefits when they retire after T-Day. Benefits accumulated up to T-Day (plus future fund returns on those benefits after T-Day) will comprise Vested Benefits and can still be taken as a taxable cash lump sum at retirement. However, contributions made after T-Day (plus fund returns on those contributions made after T-Day) will comprise Non-Vested Benefits and must be annuitized i.e., up to one-third of the Non-Vested Benefits can be taken as a taxable cash lump sum at retirement but at least two-thirds of the Non-Vested Benefits must be taken as annuity income. If the value of the Non-Vested Benefits is below R247 500.00, the full value of Non-Vested Benefits can also be taken as a taxable cash lump sum.

- Existing members of provident funds and provident preservation funds who are **55 years or older on T-Day** have the right to additional Vested Benefits. Not only will the benefits they accumulate up to T-Day (plus future fund returns on those benefits after T-Day) be regarded as Vested Benefits, their contributions made after T-Day (plus fund returns on those contributions) will also be regarded as Vested Benefits and can also be taken as a taxable cash lump sum at retirement, provided those contributions are made to the same provident or provident preservation fund. A member of a provident fund who is 55 years or older on T-Day will therefore accumulate Vested Benefits before and after T-Day in the same provident fund and will be able to take a taxable cash lump sum with his/her full share of fund at retirement provided he/she remains in the same provident fund up until retirement. If the member transfers his/her benefits to a new retirement fund, any contributions to the new fund (plus fund returns on those contributions) will comprise Non-Vested Benefits and will be subject to annuitization.

- As the T-Day changes only affect contributions made after T-Day and as provident preservation fund members cannot make contributions to such a fund, existing members of provident preservation funds (i.e., provident preservation fund members with existing benefits prior to T-Day) will not be impacted by these changes. All their benefits will be regarded as Vested Benefits and can be taken as a taxable cash lump sum at retirement.

- Vested Benefits and Non-Vested Benefits transferred to other retirement funds after T-Day will retain their nature irrespective of the retirement fund they are transferred to. However, contributions (and fund returns on those contributions) in the new retirement fund will be treated as Non-Vested Benefits and will be subject to annuitization.

- The Pension Funds Act allows for pre-retirement withdrawals and reductions of benefits due to divorce and maintenance orders, loan recoveries and compensation paid to employers. If a retirement fund member has both Vested Benefits and Non-Vested Benefits, a pre-retirement withdrawal or reduction will be applied proportionally against the Vested Benefits and Non-Vested Benefits.

2) Greater portability of retirement fund benefits across different types of retirement funds

The requirement for provident fund and provident preservation fund members to annuitize a portion of their benefits from T-Day onwards means that the distinctions between 'restrictive' retirement funds such as pension funds and 'less restrictive' retirement funds such as provident funds will fall away. As a result of the alignment of retirement funds, the ability for retirement fund members to transfer their benefits tax-free to a wider range of retirement funds will be possible after T-Day. For example, members of pension funds will now be able to transfer their benefits to provident funds tax-free, whereas such a transfer is currently taxed. Members of RA funds, however, will still only be able to transfer their benefits to other RA funds tax-free. In all cases, Vested Benefits moved to other retirement funds after T-Day will keep their vested nature and pre-existing payout terms, but contributions and returns in the new fund will comprise Non-Vested benefits and will be subject to annuitization at retirement.

3) RA fund and pension/provident preservation fund withdrawals on emigration

- Members of RA funds, pension preservation funds and provident preservation funds are currently able to take pre-retirement withdrawals from those funds if they have emigrated from South Africa and that emigration is recognized by the South African Reserve Bank ('SARB') for the purposes of exchange control.

- However, exchange control and the concept of emigration will be phased out from T-Day. As emigration will no longer be formally recognized, the current basis of allowing members of RA funds and preservation funds to take a pre-retirement withdrawal because of emigration will have to change.

- With effect from T-Day, members of RA funds, pension preservation funds and provident preservation funds will be able to take a pre-retirement withdrawal if:
  - They are or were South African residents who emigrated from South Africa and that emigration was recognized by the SARB for purposes of exchange control in respect of applications received on or before 28 February 2021 and approved by the SARB or a South African bank on or before 28 February 2022; or
  - They are not SA tax residents for an uninterrupted period of three years or longer on or after 1 March 2021.

4) What will not change on T-Day

Despite the significant changes to the retirement fund laws and assuming there are no further changes announced in the National Budget 2021, the following will not change on T-Day:

- The current tax-deductible limits for retirement fund contributions - these will remain at 27.5% of the greater of remuneration or taxable income, capped at R350 000.00 per annum.
- Allowable pre-retirement withdrawals from pension funds, provident funds, pension preservation funds, provident preservation funds and RAs these can still be accessed as taxable cash lump sums in full.
- The way cash lump sums and annuity income is taxed - cash lump sums will continue to be taxed according to the applicable retirement fund lump sum tax tables and annuity income will continue to be taxed according to the annuitant's marginal tax rates.
- The way existing members of pension funds, pension preservation funds and retirement annuity funds can access their benefits at retirement - up to one-third of their benefits can still be taken as a taxable cash lump sum at retirement but at least two-thirds of their benefits must be taken as annuity income. If the value of their retirement benefits is below R247 500.00, the full value of their retirement benefit can be taken as a taxable cash lump sum. If these members transfer vested benefits from a provident fund or provident preservation fund into their existing retirement funds after T-Day, they will still be able to take their accumulated 'Vested Benefits' as taxable cash lump sums as outlined in 1 above; and
- There are no specific changes to retirement fund charges and fees arising from the T-Day changes.

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