New Tax Treatment for Funds & Contributions

PROVIDENT FUND POST-RETIREMENT ANNUITY ALIGNMENT

Background

1. There are three basic types of retirement funds in the South African retirement system: Pension funds, provident funds, and retirement annuity funds. Retirement funds accept contributions for the benefit of (and from) members with the purpose of establishing and growing a member's retirement interest (i.e. savings). For individuals that change employers, there are preservation funds that hold retirement savings until retirement.

Contributions to retirement funds

2. Employer contributions to pension funds and provident funds are tax deductible up to certain limits. Further, while member contributions to pension funds or retirement annuity funds are tax deductible (subject to limits), no tax deduction is available for member contributions to provident funds.

Payouts from retirement funds

3. If a contribution to a retirement fund is tax deductible, the payout is taxable. If a contribution is non-deductible, the payout is tax-free. Growth is never taxed in a retirement or preservation fund and is therefore always taxable upon payout.

4. Payouts from a retirement fund can be in the form of a lump sum or an annuity. A lump sum will be taxable according to
the retirement tax tables while an annuity will be taxable according to the recipient's marginal tax rate.

**Annuitisation**

5. Pension and retirement annuity fund members are bound by a mandatory annuitisation requirement that requires the members to annuitize a part of their fund interests upon retirement (but not before). However, provident fund members are not required to annuitize any portion of fund savings. As a result, provident fund members typically receive their retirement interests as a lump sum upon retirement.

6. As a general matter, mandatory annuitisation for pension and retirement annuity funds requires that at least two-thirds of a member’s total retirement interest be paid in the form of an annuity (including a living annuity) upon retirement. These members will always be entitled to receive at least one-third of their total retirement interests in the form of a lump sum upon retirement.

7. It should be noted that where a member exits any retirement fund prior to retirement, there is no mandatory annuitisation required. Members in this situation may choose to preserve their fund interests or to receive their entire interests in the form of a lump sum.

**De minimis exception**

8. The de minimis exception overrides the mandatory two-thirds annuitisation requirement. If the total value of a fund interest at retirement does not exceed R75 000, the exception permits the member to receive the entire
retirement interest in the form of a lump sum. This exception is based on the premise that an annuity of less than R75 000 is not cost effective in terms of commission and administrative fees. This exception applies separately in respect of each membership interest in a retirement fund.

**Preservation funds**

9. Preservation funds exist to allow individuals to preserve their retirement savings when changing employers. Therefore, pension preservation and provident preservation funds cannot accept contributions from members; these funds can only accept transfers from (employer-provided) pension and provident funds.

10. Members of a pension preservation fund have the same mandatory annuitisation requirement upon retirement as pension fund members (e.g. the same two-thirds versus one-third calculation). Similarly, members of provident preservation funds (as with provident fund members) are allowed to receive their entire retirement interest in the form of a lump sum upon retirement.

**Fund-to-fund transfers**

11. In general, no tax is levied on the transfer of retirement savings from one fund to another. However, due to the lack of annuitisation requirements in provident and provident preservation funds, transfers of retirement savings to those funds are taxed if the transfer is from a retirement or preservation fund where annuitisation is mandatory. This measure ensures that retirement savings in funds that require mandatory annuitisation remain segregated from funds without mandatory annuitisation.
The Changes Affective 1st March 2015

Basic annuitisation rule

12. It is proposed that the same mandatory annuitisation requirements currently applicable to pension and retirement annuity funds be applied to provident funds as from 1 March 2015. More specifically, as from 1 March 2015, any person retiring from a provident fund or provident preservation fund cannot receive a lump sum upon retirement of more than one-third of their retirement interests. In other words, a mandatory compulsory annuity will now be required for the remaining two-thirds of their retirement interests (pre-retirement interests remains free from any mandatory compulsory annuitisation).

Protection of historic vested rights within a provident fund

13. General protective measures: In an effort to protect historic vested rights, measures will be introduced to segregate historic rights from new rights. These measures will require a certain amount of administrative intervention to succeed:

14. Balances in provident funds as at 1 March 2015 (and any subsequent growth thereon) need not be annuitized.

15. If a provident fund member is older than 55 years of age as at 1 March 2015, the mandatory annuitisation requirements will not apply to contributions made (and any growth thereon) if the member remains in the same provident fund until retirement.

16. Administrative requirements: Provident funds must maintain separate accounts in respect of a member under the age of 55 as at 1 March 2015 in order to separate pre-1 March 2015
contributions (and any growth thereon) from post-1 March 2015 contributions (and related growth). This segregation is required in order to determine what part of the member's retirement interest are subject to the mandatory annuitisation requirements versus those interests remaining under the prior dispensation. Separate accounts generally need not be maintained by a provident fund in respect of members of age 55 as at 1 March 2015 (no annuitisation required) and those that join a provident fund on or after 1 March 2015 (full annuitisation required).

17. Example 1: Provident fund member older than age 55 on 1 March 2015

   a. Facts: Member T of the United Provident Fund is aged 56 years old on 1 March 2015, at which time Member T’s fund interest is R400 000. Member T continues to contribute to the provident fund and retires at age 64. On that day, Member T’s retirement interest is R750 000.

   b. Result: Member T will be able to take the entire amount as a lump sum at retirement (as under pre-existing law). The provident fund need not keep split accounts for Member T.

18. Example 2: Provident fund member younger than age 55 on 1 March 2015

   a. Facts: Member W of Open Provident Fund is 54 years old on 1 March 2015, at which time Member W’s fund interest is R450 000 with this amount increasing by R150 000 by the year 2020. Member W also continues to pay R200 000 in contributions to the fund after 1
March 2015 until 2020 with related growth amounting to R50 000. The final retirement interest in 2020 is R850 000.

b. Fund administration: Open Provident Fund must maintain two separate accounts for Member W. One account in respect of the pre-1 March 2015 contributions and any growth thereon (R450 000 + R150 000); and another account in respect of the post-1 March 2015 contributions and related growth (R200 000 + R50 000)

c. Result: The pre-1 March 2015 contributions plus any growth thereon (R450 000 + R150 000 = R600 000) can be freely withdrawn as a lump sum. The remaining R250 000 is subject to mandatory annuitisation. Member W may only take one-third of the R250 000 as a lump sum, while the remaining two-thirds is subject to annuitisation.

Fund-to-fund transfers

19. General protective measure: The protection of provident fund vested rights will apply in respect of contributions made to a provident fund prior to a 1 March 2015 (and any growth thereon). This protection will apply irrespective of whether the retirement interest remains in the provident fund or whether the retirement interest is transferred to another retirement or preservation fund. Stated differently, a member of a retirement or preservation fund need not annuitise any contributions made to a provident fund prior to 1 March 2015 (together with any growth on those contributions).
20. Administrative requirements: If a provident fund member wants to transfer the member’s retirement interest to another retirement or preservation fund, the provident fund must be in a position to inform the transferee fund of the split of the fund interest between the value that remains subject to annuitisation and the value that continues to enjoy vested right protection. Stated differently, the provident fund must provide the split between the pre-1 March 2015 contributions (and related growth) vis-à-vis the post-1 March 2015 contributions (and related growth) for this split to recognize by the transferee fund. All other funds inheriting these split accounts must similarly retain this split for record-keeping purposes.

21. Example: Provident fund member transfers to new fund

   a. Facts: Person S, a member of Investment Provident Fund, is 29 years old on 1 March 2015, at which time the fund interest is R1 000 000.

   b. Person S continues to contribute to the provident fund. Six years later, Person S resigns. At this point, the R1 000 000 has grown to R2 000 000.

   c. The new contributions that Person S made to the Investment Provident Fund (and the growth on thereon) amounts to R500 000.

   d. Person S transfers this R2 500 000 balance to a preservation fund. When Person S turns 70, Person S resigns from the preservation fund with a retirement interest of R10 000 000.
e. The pre-1 March account of R2 000 000 grew to R8 500 000, and the subsequent amount of R500 000 grew to R1 500 000.

f. Administration: Investment Provident Fund: Investment Provident Fund must maintain an account for Person S in respect of the fund interest of R1 000 000 as at 1 March 2015 and any growth thereon (R1 000 000). Investment Provident Fund must also maintain a separate account for any contributions made after 1 March 2015 and any growth thereon (totaling R500 000).

g. When Person S transfers these amounts to the preservation fund, Investment Provident Fund must provide the preservation fund with a split of fund interests with one account falling within annuitisation (R500 000) and the other enjoying vested right protection (R2 000 000).

h. Preservation fund: The preservation fund must keep separate accounts for Person S. One account must exist in respect of the fund interest of R2 000 000 that continues to enjoy vested right protection and any growth thereon (R6 500 000). A separate account is required for the R500 000 that remains subject to annuitisation and any growth thereon (R1 000 000).

i. Result: The pre-1 March 2015 contributions plus growth thereon (i.e. R8 500 000) will remain free from annuitisation. The newer amounts (of R1 500 000) will become subject to the new dispensation. Member W
may only take one-third of the R1 500 000 as a lump sum while the remainder is subject to annuitisation.

**De minimis exception**

22. As a further measure to accommodate provident fund members and ensure a comfortable transition, the current threshold for the de minimis exception (R75 000) will be doubled to R150 000 for all retirement funds. As a result, every member may receive their entire retirement interest in the form of a lump sum as long as the portion of the member's retirement interest that is possibly subject to mandatory annuitisation (i.e. the two-thirds amount) does not exceed R150 000.

23. **Example 4: De minimis exception**

   a. **Facts:** Member T of Consolidated Provident Fund retires at 60 years of age. Member T was 48 years old on 1 March 2015, at which time Member T’s fund interest was R450 000, which increases to R600 000 upon Member T’s retirement. Prior to retirement, Member T contributed R80 000 to Consolidated Provident Fund after 1 March 2015 with growth of R40 000. The final retirement interest was R720 000.

   b. **Result:** The pre-1 March 2015 amount plus growth (i.e. R600 000) thereon is free from annuitisation. The remaining (R120 000) amount is potentially subject to mandatory annuitisation but for the de minimis threshold (R150 000). Member T can accordingly receive the entire R720 000 in the form of a lump sum.
Free portability between retirement funds

24. Due to the alignment of the mandatory annuitisation requirements between all retirement and preservation funds, a more flexible system of free portability can now be allowed. The transfer of retirement savings to provident and provident preservation funds from other funds (to the extent that a transfer is allowed) will henceforth be free from tax in all instances (e.g. pension funds can now be transferred to provident funds).

Contribution to Funds

Member contributions

25. Going forward, individual members making a contribution will receive a uniform deduction for these contributions regardless of the approved fund involved (i.e. regardless of whether the contribution is to a pension, provident or retirement annuity fund). Under this revised approach, deductible contributions will be subject to an annual percentage limit and a monetary limit.

26. Percentage limit: Deductions in respect of contributions made by the member will be allowed up to 27.5 per cent on the greater of “remuneration” or “taxable income” (excluding annuities and retirement lump sums). Potential reliance on taxable income means that self-employed individuals can make deductible contributions (or that formally employed individuals can make individual contributions based on amounts above remuneration if earning income from other sources).
27. Monetary limit: No member may deduct contributions in excess of an annual limit of R350 000. This limit ensures that wealthy individuals do not receive excessive deductions (vis-à-vis lower income individuals who do not have the means to contribute much to these funds).

28. Contributions in excess of the annual limits may be rolled over to future years where the amounts will again be deductible together with contributions made in that year, but subject to the limits applicable in that year. However, as per existing legislation, where any contributions have not been deducted as at retirement, the nominal value will be set off against any lump sum income prior to the tax calculation so as to avoid double taxation.

Employer contributions

29. Employer contributions to all approved retirement funds (South African) will be deductible against income under a specific deduction provision. The deduction will effectively be unlimited. Unlike the current position where employer contributions to benefit funds (friendly society and medical scheme) are included in the specific deduction provision, the general tax position will apply in future.

30. In certain cases (particularly in respect of defined benefit funds) employer contributions are allocable in the fund to both current and retired employees. The employer deduction will be available regardless of whether the fund allocates the contribution to a current or a retired employee. However, no fringe benefit will arise in the case of an employer contribution allocable by a retirement fund to a retired member of the fund.
**Employee fringe benefit**

31. In future, any contributions made by an employer to an approved South African retirement fund for the benefit of an employee-member will be taxed as a fringe benefit in the hands of the member. The value of the fringe benefit for tax purposes will depend on whether the contributions are made to a defined benefit fund or a defined contribution fund.

32. 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 potentially deductible. These amounts will fall within the percentage and monetary limits as outlined above.

33. **Example 1: Basic employer calculation**

   a. Facts: Employee A is a member of a provident fund. Employee A has a total cost to company (remuneration) of R300 000, which includes a basic salary of R180 000. Pursuant to the fund’s rules, the employer contribution represents 20 per cent of Employee A’s basic salary, and Employee A’s contribution represents 5 per cent of Employee A’s basic salary. In monetary terms, Employer makes a contribution of R36 000 (R3 000 per month) to the fund in the name of Employee A, whilst Employee A makes a contribution of R9 000 (R750 per month) to the fund.

   b. Result: Employee A will be taxed on the R36 000 employer contribution as a fringe benefit. However, for purposes of determining potential contributions deductions, Employee A will be deemed to have
contributed the R36 000 to the provident fund, together with Employee A’s own contributions (R9 000), totaling R45 000. Therefore, Employee A will be entitled to a deduction of R45 000 against income earned. Neither the percentage limit (27.5 per cent of R300 000 = R82 500) nor the monetary limit of R350 000 will limit the tax deduction.

34. **Example 2: Basic employer calculation with retirement annuity fund**

a. **Facts:** Employee B is a member of a pension fund. Employee B has a total cost to company (remuneration) of R300 000, which includes a basic salary of R180 000. Employee B earns rental income from a property, resulting in taxable income of R250 000. The employer contribution represents 20 per cent of Employee B’s basic salary, and Employee B’s contribution represents 5 per cent of B's basic salary. In monetary terms, Employer makes a contribution of R36 000 to a South African approved pension fund in the name of Employee B, whilst Employee B makes a contribution of R9 000. Employee B also makes a further contribution of R51 000 (R4 250 per month) to a retirement annuity fund (in respect of which Employee B has provided proof to Employer).

b. **Result:** Employee B will be taxed on the R36 000 employer contribution as a fringe benefit. However, for purposes of determining potential contributions deductions, Employee B will be deemed to have contributed the R36 000 to the pension fund, together with Employee B’s own contributions to the pension
fund totaling R45 000. Employee B's total retirement fund contributions are R96 000 (R45 000 + R51 000). The percentage limit (27.5 per cent of R300 000 = R82 500) will limit the tax deduction in respect of the contribution of R96 000 to R82 500. Therefore, B will be unable to deduct R13 500 in the current year of assessment. The R13 500 will be available for deduction in future years subject to the percentage and monetary limits applicable in those years.

35. Example 3: Basic retirement annuity fund calculation

a. Facts: Individual C is self-employed and generates R400 000 from providing consulting services. Individual C makes contributions to a retirement annuity fund during the year of assessment of R120 000 (R10 000 per month).

b. Result: The deductibility of Individual C’s deduction will be based on the higher of "remuneration" or "taxable income". In this instance, the deduction is limited to R110 000 (27.5 per cent of R400 000). The R10 000 excess can be rolled over to a future year of assessment (subject to future percentage and monetary limits).