Retirement reforms: What will change from 1 March 2015

Posted on 06/10/14 | Tags: Retirement Annuities

From 1 March 2015 a number of reforms will take effect in the retirement industry that will be to your clients' advantage and help them to retire more comfortably. Here's what we can expect.

Nearly 40% of retirees deplete their retirement lump sums early on in retirement. It takes most retirees a mere two and a half years to spend the lump sum amount of their retirement money they've carefully saved through their working lives.

To counter this and other negative trends the National Treasury is introducing a number of retirement reforms that will help South Africans to be better equipped for their golden years.

1. Tax deductibility of retirement savings contributions

Current scenario:

Different tax deductions apply to the contributions employers and employees make towards retirement savings:

For pension funds:

- Employers may deduct up to 20% of an employee's remuneration for tax purposes.
- Employees may deduct up to 7,5% of their remuneration for tax purposes.

** No monetary cap applies.*

For provident funds:

- Employers may deduct 20% of an employee's remuneration for tax purposes.
- Employees may not deduct anything for tax purposes.

** No monetary cap applies.*

For retirement annuity funds (RAs):

- Employers' contributions are taxable as a fringe benefit in the employee's hands and are then deemed to have been made by the employee.
- Employees may deduct the greater of:
- 15% of taxable income other than from retirement funding employment; or
- R3 500 less current deductible contributions to a pension fund; or
- R1 750.

Non-retirement funding income includes any investment income, but excludes income from lump sums taken on retirement. In calculating non-retirement funding income, all attributable tax deductions are taken into account.

** No monetary cap applies.*

Future scenario:

From 1 March 2015 there will be an overall limit for deductible contributions to retirement funds irrespective of whether the whole amount is contributed to one fund or a combination of pension, provident or RA funds. This change significantly simplifies the tax deductibility of retirement fund contributions.

Employers' contributions are taxable as a fringe benefit in the employee's hands and are then deemed to have been made by the employee.

Employees may deduct up to 27,5% of the higher of the person's:

- remuneration (excluding retirement fund lump sum benefits, retirement fund lump sum withdrawal benefits and severance benefits); or
- taxable income from trade (excluding retirement fund lump sum benefits, retirement fund lump sum withdrawal benefits and severance benefits) irrespective of which retirement savings vehicle(s) they use.

** R350 000 limit per annum*

2. Changes in withdrawal amount upon retirement

Please note:

The R350 000 monetary cap on tax deductions is the rand value of a 27,5% contribution towards retirement funds. Few South Africans actually contribute more than R350 000 or 27,5% per year towards their retirement savings.

According to the 2014 Sanlam Benchmark Survey the average member's contributions are 16,1% (employer and employee contributions). Even for those members who make additional voluntary contributions most of these members contribute an additional 2,65%.

Current scenario:

If the investment amount at retirement in your fund is not more than R75 000, you may withdraw the entire sum.

Future scenario:

If the investment amount at retirement in your fund is not more than R150 000, you may withdraw the entire sum.

3. Changes to provident funds

Current scenario:

The legislation states that individuals who retire are entitled to the lump sum available in their provident fund and that they may use it as they please. (But according to the Sanlam Benchmark Survey, many South Africans use this money for everyday living expenses and retirement savings are soon depleted.)

Pension funds, however, have different requirements in terms of the law. When an individual retires, he or she may take only one third as a lump sum in the pension fund. Two thirds must be used to buy a pension income – whether it's a guaranteed annuity or an investment-linked living annuity (ILLA).

Future scenario:

From 1 March 2015, the same rules will be applied to provident and pension funds. Provident fund members will be compelled to use at least two thirds of the lump sum to buy a pension income (guaranteed annuity or ILLA) in respect of all contributions after 1 March 2015 and growth thereon if the fund value exceeds R150 000.

4. Exceptions for individuals of 55 years and older

People who are 55 years and older who already contribute towards a provident fund will be exempted from the new provident fund legislation and will still be allowed to withdraw the full amount available in their provident funds upon retirement after 1 March 2015, on condition that they remain in the same fund. Vested rights are therefore protected.

People younger than 55 years who have already made contributions towards a provident fund will be treated differently. The contributions prior to 1 March 2015 plus growth thereon may be accessed in full at retirement. But if the rest of the investment exceeds R150 000, only one third of the contributions made after 1 March 2015 plus growth thereon may be -accessed at retirement. The remaining two thirds have to be used to buy a pension income.

For example

By 1 March 2015, Jane has built up an investment of R1 million in her provident fund. Upon retirement she may access the full R1 million plus any investment return earned on the R1 million (the 'old rules' money) but she may only access one third of the rest of the investment (the 'new rules' money) as the new provident fund legislation states that two thirds of the investment should be used to buy a pension income.

No need to fear

The changes to the retirement fund tax dispensation is aimed at creating a better retirement scenario for South Africans and is the result of a thorough process involving investigation, analysis, debate and industry input. There is no need to react to them with fear. Clients should, rather, be encouraged to seek advice from their intermediary on how the changes will impact them and how they can prepare in a responsible manner.

Not so fast

Be mindful of rash decisions due to the imminent changes to retirement savings. There's no need for your clients to resign, reduce contributions to their savings vehicles or withdraw benefits to 'safeguard' their savings.

We're in trouble

The average South African doesn't save enough for retirement:

- Only 29% of pensioners maintain their standard of living in retirement.
- About 21% withdraw their retirement funds when they change jobs.
- Only 58% seek financial advice before they retire.

* Source: *Sanlam Benchmark Survey 2014*

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