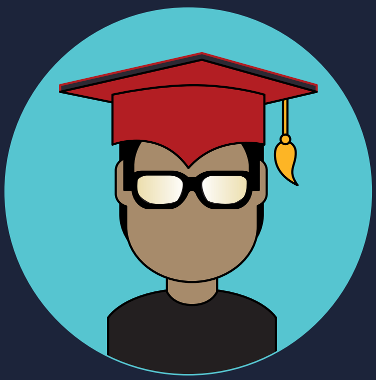


Trustee Tutor: Issue 5
Categories of retirement funds

As the T-Day reforms provided for in the Taxation Laws Amendment Act take effect on 1 March 2021, it is worthwhile to look at the different types of retirement funds and how these have changed over time.

CATEGORIES OF RETIREMENT FUNDS

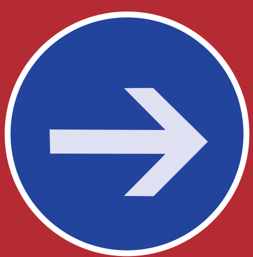
There are two broad categories of retirement funds:

1. Occupational funds

Occupational funds are, historically, those retirement funds that members belong to by virtue of their employment with a specific employer. For example, to be a competitive and sought after employer, ABC (Pty) Ltd promises certain benefits for their employees in their contracts of employment. The most cost and tax effective way to provide for some of these benefits is through an occupational retirement fund (pension fund or provident fund). In terms of the tax laws, when an employee joins ABC (Pty) Ltd, it is compulsory that they join the employer's retirement fund, in other words, eligible employees don't have a choice but to join the fund.

For completeness of this discussion, an employer can choose to set up their own retirement fund or they could choose to participate in an umbrella fund.

2. Retail funds



Retail retirement funds are those funds that an individual ***chooses*** to use to save for their retirement, in other words, membership of the fund is not compulsory, but rather discretionary. Individuals choose these types of savings vehicles for the tax benefits they offer, as well as their competitive fees (when compared to other types of discretionary savings options). Examples of retail funds are retirement annuity funds and preservation funds.

The impact of Default Regulations on these two categories …

After the default regulations on preservation came into effect on 1 March 2019, you may find members who leave their employer but choose to keep their savings in their occupational funds (preserve in the fund) – meaning that an occupational fund may now have a combination of members who belong to the fund due to their employment with the employer and members who have chosen to remain in the fund as individual investors after their employment with the employer has come to an end.

The Taxation Laws Amendment Act introduced a number of key changes on 1 March 2016 (tax deductibility of contributions) and then again on 1 March 2021 (payment of benefits on retirement) to align the different types of retirement funds. These changes were done to ensure fairness to members through consistency of tax treatment and to compel members to preserve (or save) their money on retirement.

Therefore, to understand the evolution of the different types of retirement funds, one needs to look specifically at the tax deductibility of the contributions paid into the fund and the way in which retirement benefits may be taken when a member retires. We also look at the changes to transfers between funds to demonstrate further how alignment has been implemented.

WHAT IS A PENSION FUND?

A pension fund is a retirement fund set up by an employer to support employees in providing financially for their retirement and to provide benefits to their families should the employee (member) pass away.

Tax deductibility of contributions paid into the fund – before **1 March 2016**	Member contributions: up to 7,5% of approved remuneration Employer contributions: up to 20% of approved remuneration (Fringe benefit tax on employer contributions was not payable in the hands of the member)
Tax deductibility of contributions paid into the fund – after **1 March 2016**	A total of 27,5% of the greater of remuneration or taxable income. The overall tax deductible limit is R350 000 each year. Contributions over this limit are allowed, but will not qualify for a tax deduction. (Contributions made by the employer is taxed as a fringe benefit in the hands of the member)
How the retirement benefit is paid out – before **1 March 2021**	A member may take a maximum of 1/3 of their accumulated balance in the fund in cash, and the remaining 2/3rds must be used to buy a pension (or annuity). If the member's accumulated balance was less than R75 000, the full amount could be taken in cash on retirement.
How the retirement benefit is paid out – after **1 March 2021**	A member may take a maximum of 1/3 of their accumulated balance in the fund in cash, and the remaining 2/3rds must be used to buy a pension (or annuity). If the member's accumulated balance is less than R247 500, the full amount may be taken in cash on retirement.
Transfers – before **1 March 2016**	Transfer tax free to a pension fund, pension preservation fund or RA fund.
Transfers – **after 1 March 2016**	Transfer tax free to a pension fund, pension preservation fund or RA fund.
Withdrawal benefit **(no changes)**	Members may take a cash lump sum on withdrawal.

WHAT IS A PROVIDENT FUND?

A provident fund is a retirement fund set up by an employer to support employees in providing financially for their retirement and to provide benefits to their families should the employee (member) pass away.

Tax deductibility of contributions paid into the fund – before **1 March 2016**	Member contributions: not tax deductible Employer contributions: up to 20% of approved remuneration (Fringe benefit tax on employer contributions was not payable in the hands of the member)
Tax deductibility of contributions paid into the fund – after **1 March 2016**	A total of 27,5% of the greater of remuneration or taxable income. The overall tax deductible limit is R350 000 each year. Contributions over this limit are allowed, but will not qualify for a tax deduction. (Contributions made by the employer is taxed as a fringe benefit in the hands of the member)
How the retirement benefit is paid out – before **1 March 2021**	A member may take a maximum of 1/3 of their accumulated balance in the fund in cash, and the remaining 2/3rds must be used to buy a pension (or annuity).
How the retirement benefit is paid out – after **1 March 2021**	A member may take a maximum of 1/3 of their accumulated balance in the fund in cash, and the remaining 2/3rds must be used to buy a pension (or annuity). [(1)] If the member's accumulated balance is less than R247 500, the full amount may be taken in cash on retirement.
Transfers – before **1 March 2016**	Transfer tax free to a pension or provident fund, a pension or provident preservation fund, or to an RA fund.
Transfers – after **1 March 2016**	Transfer tax free to a pension or provident fund, a pension or provident preservation fund, or to an RA fund.
Withdrawal benefit **(no changes)**	Members may take a cash lump sum on withdrawal.

[(1)] It is very important to note that this applies only to contributions made after 1 March 2021 by members younger than 55 years old. All balances saved up to 28 February 2021 are still able to be taken as a full cash lump sum at retirement. And members over 55 are still able to take their whole accumulated balance in cash on retirement (provided they don't change funds). (There is more detail on how accumulated balances as at 28 February 2021 will be treated on retirement in this issue's Legal Update – explaining compulsory annuitisation.)

WHAT IS A RETIREMENT ANNUITY (RA) FUND?

A retirement annuity fund is a retail fund that an individual chooses to invest in to make financial provision for their retirement. It is a tax effective way for an individual to save for retirement – either if they are self-employed and therefore do not have an employer fund, or if they wish to save more outside their employer's fund by making additional contributions to maximise the 27,5% allowable deduction.

Tax deductibility of contributions paid into the fund – before **1 March 2016**	A maximum of 15% of non-taxable income
Tax deductibility of contributions paid into the fund – after **1 March 2016**	A total of 27,5% of the greater of remuneration or taxable income. The overall tax deductible limit is R350 000 each year. Contributions over this limit are allowed, but will not qualify for a tax deduction.
How the retirement benefit is paid out – before **1 March 2021**	A member may take a maximum of 1/3 of their accumulated balance in the fund in cash, and the remaining 2/3rds must be used to buy a pension (or annuity). If the member's accumulated balance was less than R75 000, the full amount could be taken in cash on retirement.
How the retirement benefit is paid out – after **1 March 2021**	A member may take a maximum of 1/3 of their accumulated balance in the fund in cash, and the remaining 2/3rds must be used to buy a pension (or annuity). If the member's accumulated balance is less than R247 500, the full amount may be taken in cash on retirement.
Transfers – before **1 March 2016**	Members may transfer to another RA fund only and this transfer is tax free.
Transfers – **after 1 March 2016**	Members may transfer to another RA fund only and this transfer is tax free.
Withdrawal benefit **(no changes)**	Members may not withdraw from an RA fund before age 55 (whereupon they would take a retirement benefit).

One last important comment on contributions: the 27,5% tax allowable contribution is aggregated across pension, provident and RA funds, meaning an individual may claim a tax deduction on a total maximum contribution of 27,5% to any (or all 3) of these funds.

So what's the bottom line?

In essence, from 1 March 2021, there will be no differences between pension funds and provident funds. In fact, new impending legislation will simply refer to them as retirement funds. This will be the completion of the alignment of these funds to ensure fairness and consistency, and encourages individuals to save more for retirement.

You can also see that the (now aligned) rules around how a retirement benefit may be taken, compels members to preserve their savings for longer into their retirement years.

But there are also funds that don't receive regular contributions but rather once off lump sum payments ...

What is a preservation fund?

If a member leaves their employer and decides to take his withdrawal benefit in cash from their employer's retirement fund, they would pay tax on any cash amounts taken over R25 000 (according to the current tax tables). A member could avoid this tax by:

- Preserving their benefit in their employer's fund, or
- Transferring their benefit to a preservation fund.

The following are some of the features of a preservation fund:

Tax deductibility of contributions paid into the fund
Members do not make contributions to preservation funds

Withdrawal benefits
Members are able to make a once off withdrawal from their preservation fund (up to the full balance in the fund) before they reach retirement age (normally set at age 55).

Retirement benefit
A member may take a maximum of 1/3 of their accumulated balance in the fund in cash, and the remaining 2/3rds must be used to buy a pension (or annuity).

(Similar to pension and provident funds above, retirement benefits from preservation pension and preservation provident funds were aligned on 1 March 2021.)
If the member's accumulated balance is less than R247 500, the full amount may be taken in cash on retirement.

Although the default regulations introduced in 2019 allows members to preserve their withdrawal benefits in their previous employer's fund (thereby avoiding tax), there are still a couple of reasons why a member may choose to transfer to a preservation fund:

- A preservation fund offers a once off withdrawal of your savings before retirement age.
- The preservation fund may offer choice of a more attractive range of investment portfolios than the occupational retirement fund.

Retirement and investment funds operate in a framework of complicated legislation and in a market of seemingly never ending choices. For this reason, the Financial Advisory and Intermediary Services Act regulates who can advise the public on these financial products. Advisers need to remain fit and proper, behave with honesty and integrity, and give their clients the most appropriate financial planning advice to meet the client's identified financial needs. This is why non-accredited people, like trustees, management committee members, human resources staff, amongst others, should not be offering members any form of advice on their retirement fund options or investments.

What is an unclaimed benefit fund?

Historically, an unclaimed benefit is a benefit that had not been paid to or claimed by a member within 24 months from when it became due for payment. These benefits were due to members of a retirement fund who did not claim their benefit when their employment ended, or their beneficiaries who did not provide the necessary information to enable the fund to pay their allocated benefits.

Once a member's benefit became unclaimed, in other words after 24 months, the retirement fund could transfer this benefit to an unclaimed benefit fund. An unclaimed benefit fund is thus a fund set up to specifically receive and deal with unclaimed benefits.

However, on 1 March 2019 the default regulations brought into effect in-fund preservation. Regulation 38 provides that when an employee leaves an employer before retirement date, the employee must be made paid-up until the fund receives an instruction in writing. In other words, these members can no longer be regarded as unclaimed after 24 months.

Thus, after 1 March 2019 the need for unclaimed benefit funds diminished significantly – with the only possible future use being for those beneficiaries who are due death benefits but do not submit the necessary information to enable the fund to pay these benefits.

What is a beneficiary fund?

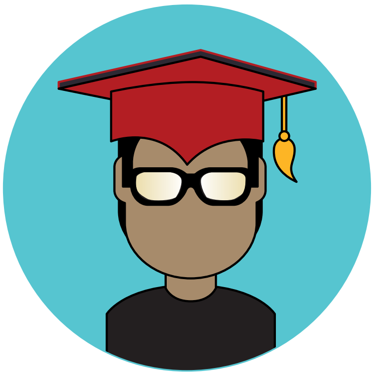
A beneficiary fund is a uniquely South African retirement fund designed to receive benefits allocated to beneficiaries of deceased members of retirement funds, where these beneficiaries may not be suited to receiving their benefits in a cash lump sum.

Section 37C of the Pension Funds Act governs the payment of death benefits from retirement funds – pension, provident, RA and preservation funds. In terms of this legislation, death benefits payable from a retirement fund do not form part of the deceased member's estate and are thus not subject to the deceased member's will. The retirement fund trustees have the duty and discretion to distribute the benefit to the deceased member's dependants in a fair and equitable manner taking into account the extent of their financial dependency.

It sometimes happens that the intended recipients of these benefits may not be suited or equipped to manage these often large lump sums, for example a minor child without a clear guardian or a mentally incapacitated adult dependant. In these instances, the trustees of the retirement fund may pay the benefit into a beneficiary fund to be managed carefully by the beneficiary fund's trustees on behalf of that beneficiary. The beneficiary fund will prudently invest the benefit to pay regular amounts in respect of the beneficiary's expenses for things like education, medical needs and general upkeep. When the minor child beneficiary reaches the age of 18 any balance left over in the beneficiary fund will become payable as a cash lump sum.

These are all the types of retirement funds in the South African context. Although they are all designed to meet a different need, they do share some similarities. All of these funds are legal entities separate from the employer or the fund sponsor and are managed by a board of trustees. Trustee Tutor 1 in the Q1 2020 issue of Pensions World looked at the duties and responsibilities of trustees when managing retirement funds. And secondly all of these funds invest in appropriate investments to meet the needs of their different members, in fact many offer members a wide choice of where to invest their retirement savings.

This issue of Trustee Tutor has looked into the various types of retirement funds, and shared the changes that have supported the government's stated aim to align the different types of funds into a simpler and fairer system, that encourages members to save for their retirement while working and into their retirement years.



Trustee Tutor: Issue 5
Categories of retirement funds

For an on-line version of the required reading material as well as electronic CPD Submission form, go to https://www.pensionsworldsa.co.za or https://www.ebnet.co.za

How to?

Answer all the questions by inserting the correct answer(s) into the block provided next to each question, scan the pages and email to Toni Cantin at ICTS, using cpd@icts.co.za

1. Choose the most correct answer: An occupational retirement fund is:

a. A discretionary savings fund to which all employees in a particular occupation contribute. ☐
b. A discretionary savings fund to which all employees at a particular employer contribute. ☐
c. A compulsory savings fund to which all employees in a particular occupation contribute. ☐
d. A compulsory savings fund to which all employees at a particular employer contribute. ☐

2. One of the consequences of the default regulations on preservation is that you might find members who were previously considered retail members, in traditionally considered occupational retirement funds.

a. True ☐
b. False ☐

3. An example of a retail retirement fund is:

a. A preservation pension fund. ☐
b. A preservation provident fund. ☐
c. A retirement annuity fund. ☐
d. All of the above. ☐

4. On 1 March 2016, the following changes to tax legislation were made:

a. Members were allowed to contribute a maximum of 27,5% of the greater of remuneration or taxable income on a tax deductible basis to a retirement annuity fund. ☐
b. Members were allowed to contribute a maximum of 27,5% of approved remuneration to a pension fund. ☐
c. All members could contribute R350 000 per year on a tax deductible basis to a provident fund. ☐
d. A loophole was created whereby members were able to contribute more than 27,5% of the greater of remuneration or taxable income on a tax deductible basis, if they contributed to more than one retirement fund. ☐

5. From 1 March 2021:

a. A member who resigns can take his full accumulated fund balance in cash from a pension fund. ☐
b. A member who resigns can take his full accumulated fund balance in cash from a provident fund. ☐
c. A member who resigns can take his full accumulated fund balance in cash from a retirement annuity fund. ☐
d. a and b only. ☐

Trustee Tutor: Issue 5 - Categories of retirement funds

6. Which piece of South African legislation governs who may give advice on financial products?

a. The Retirement Funds Act
b. The Conduct of Financial Advisors Bill
c. The Financial Advisory and Intermediary Services Act
d. The Financial Crimes Control Act

7. Which of the following statements is incorrect.

a. Member contributions to a retirement annuity fund are tax free to certain maximums.
b. Member contributions to a preservation pension fund are tax free to certain maximums.
c. Member contributions to a provident fund are tax free to certain maximums.
d. Member contributions to a pension fund are tax free to certain maximums.

8. In some instances, members of provident funds, pension funds and retirement annuity funds are able to take their full retirement benefit as a cash lump sum.

a. True
b. False

9. Choose the most correct answer: An unclaimed benefit fund:

a. Is used for those members who don't wish to belong to their employer's fund.
b. Is used for those beneficiaries who don't wish to receive their benefits in cash.
c. Is no longer required in the retirement funds industry.
d. Is used for those beneficiaries who don't provide their payment details to the fund.

10. Retirement funds in South Africa have the following in common:

a. They are managed by a board of trustees.
b. The need to comply with Regulation 28 to the Pension Funds Act.
c. The need to comply with the requirements of the Treating Customers Fairly framework.
d. All of the above.

Email to Toni Cantin at ICTS, using cpd@icts.co.za