



..retirement revolution..

TEN WAYS TO SAVE TAX WITH A RETIREMENT ANNUITY

1. What is a retirement annuity?

A retirement annuity is nothing more than a one-person pension plan. A person applies to become a member of a retirement annuity (RA) fund, which is approved as such by the Registrar of Pension Funds and the tax authorities. No employer/employee relationship is required to qualify for membership.

RA's are the main savings vehicle for self-employed persons to accumulate funds for retirement in a tax-efficient way. They are also popular as a top-up plan for salaried employees (which includes directors of companies and members of CC's) who belong to pension or provident funds, to close the income gap at retirement.

Smaller employers often choose RA's for their staff over traditional pension schemes, thereby avoiding the administration and responsibility involved in operating the latter schemes¹.

2. Tax savings

Most people know that contributions to an RA are tax-deductible up to a certain maximum, but few people realise that an RA may actually provide them with an opportunity to save tax in 10 different ways, namely: -

- (i) Contributions are tax-deductible up to a certain maximum (e.g. if you fall in the 40% maximum marginal tax rate, then the Receiver is sponsoring almost half of your contribution towards your retirement).
- (ii) You can deduct a further R1 800 per year in respect of arrear contributions (these are really re-instatement contributions).
- (iii) Disallowed contributions can be carried over to the next year of assessment and, if unused during the contribution period, can be offset at retirement to increase the tax-free portion of the lump sum, or **claimed as a tax deduction** against income from the annuity purchased with the non-commuted amount.

¹ RA fund contributions that are paid by an employer from pre-tax income of the employee were from 1 March 2010 a deduction for the member. However, the employer will have to treat such payment as taxable in the hands of the employee and at the same time take a member contribution deduction by the employee into account for PAYE purposes.

- (iv) The abolition of retirement fund tax as announced in the 2007-budget speech by the Min. of Finance means that, with effect from 1 March 2007, no tax on interest or rental income would be imposed on the fund. This benefits anybody who pays tax. Therefore no tax at all will be paid on the build-up, as dividend income and capital appreciation is tax-free **and capital gains tax is not applicable**. This is like having a tax-exempt share portfolio.
- (v) Your lump sums at death, disability or retirement are tax-free up to a certain amount (**R 300 000** in total at present plus disallowed contributions). This formula changed with effect from 1/10/2007.
- (vi) The balance of the lump sum is taxed at a more concessionary rate of tax on a sliding scale. On a lump sum in excess of R 300 000 but no more than R 600 000 @ 18%; between R 600 000 & R 900 000 @ 27% and @ 36% on lump sums in excess of R 900 000. Because you can stagger your retirement with an RA you can mature your RA at any time after age 55 (previously not beyond age 70). With an employer pension or provident fund, you have to retire from your employer & fund at the same time.
- (vii) On death, only the value of the compulsory annuity purchased with the fund benefit was free of **estate duty**. These days the **entire** proceeds of the RA (including the lump sum) are **exempt** from estate duty!² This provides a fantastic planning opportunity for the wealthy estate owner to make a large single-premium contribution to an RA to reduce his or her estate for estate duty purposes). There is no limit on the amount or the timing of such a payment- as long as it happens before death obviously. *[You could also donate a lump sum to your spouse (donations tax exempt) thereby saving estate duty of 20%. The spouse can then use that money to fund an RA, which she can mature at 55. Even if that spouse is not earning taxable income the contributions can be tax-deductible later as set out in (ii) above]. Should that spouse pass away her RA will also be completely free of estate duty!*
- (viii) If you resign from your employer and receive a withdrawal benefit from your pension or provident fund, you can preserve your retirement benefit by transferring it into either a preservation fund or an RA fund, on a tax-exempt basis. This includes former public sector members (e.g. GEPP & local authority employees), whose pre- 28/02/1998 tax-exempt benefits will be preserved.
- (ix) On retirement, you have a choice between two types of compulsory life annuities, namely an underwritten annuity and an investment-linked living annuity, or even a combination thereof. Assuming your risk profile justifies the decision, by choosing the investment-linked living annuity you can manage the income you receive (between 2.5% and 17.5% of the capital amount each year) and consequently also manage

² With respect to the estates of persons dying on or after 1 January 2009.

your income tax position. Another advantage is that any growth on the assets backing the annuity is not taxed as only the income you receive is taxed in your hands.

- (x) Most people experience a big increase in medical expenses once they retire. Thankfully, once you have reached age 65, your medical expenses become fully tax-deductible. An RA can be used to build up a fund for post-retirement medical expenses in a tax-efficient way, as we have already seen. On retirement although the annuity is fully taxable, to the extent that it is used to cover medical expenses it is deductible again. It's therefore, in essence, tax-free.

Conclusions

"These tax savings can be substantial and can greatly improve the overall return on your investment. However, surprisingly for many, the biggest advantage of an RA may not be tax-related at all. An RA is a disciplined way of saving on a regular contractual basis (not an "if I can spare it" kind) that can also be made to give guaranteed results. The fact that the capital cannot be accessed before at least age 55 [except in the case of disability] is often a blessing in disguise.

This means that you are more likely to reach retirement with some capital to produce a retirement income if you follow the RA route, unlike many other types of liquid investment which, experience shows, are raided for other purposes long before retirement."

(Source: Insurance & Tax Vol. 15, No 1 March 2000; pp 16)

I am sure you are familiar with the ANNUAL tax deduction limits³:

The greater of-

- 15 % of non-retirement funding **taxable** income⁴; or
- R 3500 – (minus) **deductible** contributions to a pension &/or provident* fund; or
- R 1750

*Logically if on a Provident Fund- which only allows deductible contributions by the employer – the limit is R 3500 pa.

With the "**Stratus International Retirement Annuity**" other benefits such as rand hedging and regional diversification arise. All in the comfort that Sanlam has structured the product in accordance with regulation, with the blessing of the authorities.

³ Sec 11 (n) ITA.

⁴ Includes taxable withdrawals and the 80% taxable portion of car allowances w.e.f. 1/3/2010.

Now that retirement annuities funds have improved values for fund members in the event of premature termination or variation of the contract, the attractiveness of RA's is even more apparent.

NB: Sanlam also pays a “loyalty bonus”⁵ every 3rd plan anniversary as well as at termination after the plan option date.

The Stratus and Topaz platforms also offer a wide range of risk-profiled portfolios.

Something that is relatively **new** to the market from Sanlam is a LISP RA (**Stratus and Cobalt for Professionals Linked Retirement Annuity**). Investment funds from all major asset managers are available.

⁵ Rebate of certain charges on ‘committed plans’ only.