momentum

Legal update

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Provident fund post-retirement alignment

Summary

The Taxation Laws Amendment Act No. 31 of 2013 that was published in Government Gazette No. 37158 on 12 December 2013 changes the tax treatment of contributions and aligns the annuitisation requirements between pension, provident and retirement annuity funds. Legal Update 3 of 2014 addresses the taxation of retirement fund contributions. This Legal Update explains the post-retirement alignment between retirement funds.

The following three major changes about the post-retirement alignment will come into effect on 1 March 2015:

1. A member of a provident fund will no longer be able to take their whole retirement benefit in a lump sum. They will only be able to take 1/3rd in a lump sum, while the rest of the benefit must be used to buy a pension (annuity), the same as with a pension and a retirement annuity fund. However, the member's vested rights will be protected and they will still be able to take the portion of their benefit that built up before 1 March 2015, plus the growth, in a lump sum. The 1/3rd restriction will not apply to a member who is over the age of 55 on 1 March 2015, unless the member transfers to another retirement fund. It also does not apply to paragraphs (a) and (b) pension funds.

2. The *de minimus* threshold has been increased from R75 000 to R150 000. This means that if a member's total benefit at retirement in a specific fund is less than or equal to R150 000, they can take their whole benefit in a lump sum. It will then not be necessary for them to take 1/3rd of the benefit in a lump sum and buy a pension with the rest. The current *de minimus* threshold applies to pension, pension preservation and retirement annuity funds. The new threshold of R150 000 will apply to pension, pension preservation, provident, provident preservation and retirement annuity funds.

3. Following the post-retirement alignment, a member will also be able to transfer between a pension and provident fund and *vice versa* without incurring any tax liability.

Current position for benefit pay-outs

	Pension / Retirement Annuity Fund	Provident Fund
Retirement payout / annuitisation	At least 2/3rds must be used to buy a pension (annuity).	Member may take entire benefit as a lump sum.
Taxation of retirement payout	Lump sum taxed according to retirement tax tables. Pension taxed at member's marginal tax rate.	Lump sum taxed according to retirement tax tables.
De minimus exception	If the total benefit is less than or equal to R75 000, the entire benefit can be taken as a lump sum.	N/A

Current position for tax-free fund to fund transfers

From	To
Pension Fund	Pension Fund Pension Preservation Fund Retirement Annuity Fund
Pension Preservation Fund	Pension Fund Pension Preservation Fund Retirement Annuity Fund
Provident Fund	Pension Fund Pension Preservation Fund Provident Fund Provident Preservation Fund Retirement Annuity Fund
Provident Preservation Fund	Pension Preservation Fund Provident Fund Provident Preservation Fund Retirement Annuity Fund
Retirement Annuity Fund	Retirement Annuity Fund

The general rule for fund-to-fund transfers is that if the member transfers from a fund that is less restrictive to a fund that is more restrictive, the transfer will be tax-free. For example, if a member transfers from a provident fund (where they are allowed to take their whole retirement benefit in a lump sum) to a pension fund (where they can only take 1/3rd of the retirement benefit in a lump sum), the transfer will be tax-free.

It is Government's policy to encourage a secure post-retirement income in the form of a mandatory pension to make sure that retirees do not spend their retirement fund benefits too quickly and then outlive their retirement savings and become dependent on the State. To do this, provident fund members will become subject to the same annuitisation requirements as those applying to members of pension and retirement annuity funds.

Position from 1 March 2015 for benefit pay-outs in provident funds

	Pre-1 March 2015 portion of benefit	**Post-1 March 2015 portion of benefit**
Retirement: Member younger than 55 years on 1 March 2015	Benefit plus growth may be taken as a lump sum.	Member is required to buy a pension with at least 2/3 rds of the benefit. Up to 1/3rd of the benefit may be taken as a lump sum.
Retirement: Member older than 55 years on 1 March 2015	Entire benefit can be taken as a lump sum upon retirement.	Entire benefit can be taken as a lump sum upon retirement for contributions to the same retirement fund as at 1 March 2015.
De minimus exception	N/A	If amount subject to annuitisation is less than or equal to R150 000, member can take entire benefit as a lump sum.

From 1 March 2015, a member who retires from a provident fund will have to buy a pension with at least 2/3 rds of their benefit. The same requirement already applies to pension and retirement annuity funds. The member will however still be able to take that part of their benefit that accrued up to 1 March 2015, plus the growth, in a lump sum. This protection of their vested rights will apply even if they transfer to another fund. In practice this means that a provident fund will have to maintain two records for each member – one for the benefit that accrued before 1 March 2015, plus the growth, and one for the benefit that accrued after 1 March 2015, with the growth. The following example illustrates what will happen from 1 March 2015.

Facts:

Mark is a member of P Provident Fund on 1 March 2015.

Mark's benefit on 1 March 2015 is R400 000. The growth on this is R50 000 per year.

Mark continues to contribute R100 000 to his benefit every year. The annual growth on this is also R50 000 per year.

On 1 March 2017 Mark transfers to T Pension Fund.

On 29 February 2020 Mark retires from T Pension Fund.

Result:

P Provident Fund has to keep two records for Mark – one for the R400 000 benefit that Mark accrued before 1 March 2015, plus the growth, and one for the benefit that accrued after 1 March 2015, with the growth.

On 1 March 2017 the amount in Marks's pre-1 March 2015 account is R500 000 (R400 000 + [R50 000 x 2]). On that same date, the amount in Mark's post-1 March 2015 account is R300 000 ([R100 000 x 2] + [R50 000 x 2]).

When P Provident Fund transfers Mark's benefit to T Pension Fund, P Provident Fund must indicate the value of the two accounts.

T Pension Fund in turn must also have two records for Mark. Record 1 will reflect Mark's pre-1 March 2015 benefit plus growth, and record 2 will be for Mark's post-1 March 2015 amount. T Pension Fund will put the R500 000 transferred from Mark's pre-1 March 2015 account at P Provident Fund to Mark's pre-1 March 2015 account in T Pension Fund and the R300 000 transferred from Mark's post-1 March 2015 account at P Provident Fund to Mark's post-1 March 2015 account in T Pension Fund.

When Mark retires on 29 February 2020, the amount in his pre-1 March 2015 account will be R650 000 (R500 000 + [R50 000 x 3]). Mark can take this benefit in a lump sum. The amount in his post-1 March 2015 account will be R750 000 (R300 000 + ([R100 000 x 3] + [R50 000 x 3]). Mark will only be able to take R250 000 of his benefit in a lump sum and will have to buy a pension with the remaining R500 000.

The Taxation Laws Amendment Act provides that the 1/3rd restriction will not apply to a person who is a member of a provident fund and who is 55 years or older on 1 March 2015, as long as that member stays in the same fund. He will lose his vested rights with regards to the contributions made after 1 March 2015 in another fund.

A member of a provident fund who is 55 years at 1 March 2015 will be able to take the following in a lump sum at retirement: the benefit that accrued before 1 March 2015, plus the contributions made by him after 1 March 2015 to that same provident fund, together with the growth on both the pre- and the post-1 March 2015 contributions. If this member stays in the same provident fund, he will be able to take his whole benefit at retirement in a lump sum. If he however transfers to another fund, only the benefit that accrued to him while he was a member of the provident fund of which he was a member on 1 March 2015 plus subsequent growth on that portion can be taken in a lump sum. For example, if Mark in the earlier example was 55 years old on 1 March 2015, he would be able to take the R800 000 that was transferred to T Pension Fund on 1 March 2017, plus growth, in a lump sum when he retires in 2020. The balance of his benefit must be used to buy a pension, subject to the *de minimus* exemption. T Pension Fund will have to keep two records for Mark – one for the amount that was transferred from P Provident Fund on 1 March 2017, plus growth, and another one for the contributions made to T Pension Fund after the transfer, plus growth.

The 1/3rd restriction will also not apply to a pension fund as defined in paragraphs (a) and (b) of the definition of "pension fund" in section 1 of the Income Tax Act. Such a pension fund, which is defined as a provident fund in the Second Schedule to the Income Tax Act, is allowed to have a retirement lump sum benefit in excess of the 1/3rd restriction. A member of for example a municipal pension fund whose rules currently allow for their members to take their whole retirement benefit in a lump sum will therefore still be able to take their whole retirement benefit in a lump sum after 1 March 2015.

The *de minimus* exemption amount will be increased from R75 000 to R150 000 on 1 March 2015. That means that if the retirement benefit of a member of a retirement fund is R150 000 or less, the member would be able to take their whole benefit in a lump sum; he will not be required to buy a pension with at least two-thirds of his benefit. This rule applies per fund, in other words a member who has three fund benefits, each of which is less than R150 000, will be able to take all three benefits in a lump sum.

Position from 1 March 2015 for tax-free fund to fund transfers

From	To
Pension Fund **Pension Preservation Fund** **Provident Fund** **Provident Preservation Fund**	Pension Fund Pension Preservation Fund Provident Fund Provident Preservation Fund Retirement Annuity Fund
Retirement Annuity Fund	Retirement Annuity Fund

From 1 March 2015, transfers between all occupational retirement funds (pension, pension preservation, provident and provident preservation funds) and transfers from any occupational fund to a retirement annuity fund will be tax-free. A member in a retirement annuity fund will still only be able to transfer to another retirement annuity fund. The reason for this restriction is that a retirement annuity fund has a restriction that no other retirement fund has – a member in this fund cannot withdraw from the fund before retirement.

Impact on FundsAtWork

Members younger than 55 on 1 March 2015: FundsAtWork will have to keep separate records / accounts for all members in a provident fund in order to separate pre-1 March 2015 contributions and growth from post-1 March 2015 contributions and growth. This will enable FundsAtWork to determine what part of the member's benefit must be subject to annuitisation rules on retirement. It will also enable FundsAtWork to advise the receiving fund of a member transferring from the provident fund which part of the member's benefit is pre-1 March 2015. It does not mean that separate record-keeping will be restricted to provident funds; pension funds should also be able to accommodate dual record-keeping to enable the splitting of the pre- and post-1 March 2015 records of members under the age of 55 transferring into the pension fund from a provident fund.

Members 55 or older on 1 March 2015:

1) ***Existing members***: FundsAtWork will not be required to have separate record-keeping for members in a provident fund that are 55 or older on 1 March 2015 as the whole benefit for these members can still be taken as a lump sum.
2) ***New members***: FundsAtWork will have to keep separate records / accounts for all new members that come from a provident fund and who are 55 or older on 1 March 2015. The amount transferred from the provident fund of which the member was a member on 1 March 2015, plus the growth, must be separated from the contributions and growth after the transfer. The member will be able to take the pre-transfer amount in a lump sum on retirement; the post-retirement benefit must be used to buy a pension, unless the *de minimus* exemption applies.

The administration system will apply the *de minimus* exemption on provident funds from 1 March 2015. It will allow a member whose post-1 March 2015 benefit is less than R150 000 to take that benefit in a lump sum.

Switch forms and the system supporting switching will be changed to distinguish between the pre- and post-1 March 2015 portion of a member's retirement savings account as members may wish to apply different investment strategies to the two portions of their savings.

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