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Legal Update

1 of 2021: Demystifying the impact of the new annuitisation legislation on members of the FundsAtWork Umbrella Provident Fund

*Please read this Legal Update together with **Legal Update 4** of 2014 and **Legal Update 4** of 2016 and substitute the dates 1 March 2015 and 1 March 2016 with 1 March 2021.*

Introduction

Following the passing of the Taxation Laws Amendment Act of 2021 on 20 January 2021, the much-anticipated proposals allowing for the annuitisation of provident funds finally became law from 1 March 2021. The annuitisation of provident funds is part of Government's intention to align the retirement benefits of provident funds to pension and retirement annuity funds.

These are the basic principles of the impact of the annuitisation legislation on the members of the FundsAtWork Umbrella Provident Fund.

Impact on retirement benefits

Provident fund members were previously allowed to take their total retirement savings as a cash lump sum benefit on retirement. From 1 March 2021, they will only be allowed to take their total **vested benefit** as a lump sum benefit. They will have to buy an annuity with at least 2/3rds of **their non-vested benefit**, unless it is less than R247 500 (i.e. the de minimis amount). Where the benefit is less than this amount, the total non-vested benefit can be taken as a lump sum benefit.

The vested benefits of provident fund members **55 years or older on 1 March 2021** will be made up of their accumulated retirement savings in the FundsAtWork Umbrella Provident Fund on 28 February 2021 plus the investment growth until retirement, as well as all the contributions they make to the Fund after 1 March 2021 and the investment growth on those contributions. Their non-vested benefits will be made up of all the contributions they make to another fund if they transfer to another fund after 1 March 2021. As long as members who are older than 55 stay in the FundsAtWork Umbrella Provident Fund from 1 March 2021 to their retirement date, they will still be allowed to take their total retirement savings as a cash lump sum and will not be required to annuitise any portion.

The vested benefits of provident fund members **younger than 55 on 1 March 2021** will be made up of their accumulated retirement savings in the FundsAtWork Umbrella Provident Fund on 28 February 2021, plus any investment growth earned until the member's retirement. Their non-vested benefits will be made up of all the contributions they make to the FundsAtWork Umbrella Provident Fund, or any other fund to which they transfer after 1 March 2021, plus any investment growth earned on these contributions until their retirement.

The practical impact of the new annuitisation legislation on retirement benefits means that the FundsAtWork Umbrella Provident Fund will maintain two records for members, i.e. one for their vested benefit and one for their non-vested benefit. If, for example, a member transfers to a pension fund in 2022, the FundsAtWork Umbrella Provident Fund will transfer these two records to the pension fund, which in turn will then also have to maintain these two separate records. If the member then retires from that pension fund, they will still be able to take their total vested benefit as a cash lump sum.

Impact on approved lump sum disability benefits

The lump sum disability benefit payable by a fund to a member who is no longer employed because they are permanently disabled, is made up of a member's accumulated retirement savings on the date of disability plus an approved insurance benefit. In terms of the Income Tax Act, the lump sum disability benefit can be processed as a retirement benefit, which means the disabled member will be allowed to take 1/3rd as a cash lump sum and needs to use the balance to buy an annuity. Alternatively, it can be processed as a withdrawal benefit which means the member can take it as a cash lump sum. In the second scenario, the policy wording of the lump sum disability benefit and the fund's rules must allow for it and the member will pay higher tax as it is a withdrawal.

The rules of the FundsAtWork Umbrella Provident Fund specify that the benefit will be processed as a retirement. This means that:

- For members who are 55 or older on 1 March 2021, both the retirement savings and the approved insured benefit components of the disability benefit will form part of the vested benefit of the member. However, if the member transfers to another fund after 1 March 2021 and becomes disabled under the new fund, the contributions made to the new fund as well as the approved insured benefit component will form part of the member's non-vested benefit.

- For members who are younger than 55 on 1 March 2021, the retirement savings component of the disability benefit will be split between the member's vested benefit (that is the retirement savings in the Fund on 28 February 2021) and their non-vested benefit (that is new contributions made to any fund from 1 March 2021). The full amount of the approved insured benefit component of the lump sum disability benefit will form part of the member's non-vested benefit. This means that the disabled member will only be allowed to take 1/3rd of the approved insured benefit as a cash lump sum except if the amount is less than R247 500, in which case the disabled member will be able to take the full amount as a cash lump sum.

Impact on withdrawal benefits

The new annuitisation legislation will not change the position of members that withdraw from the FundsAtWork Umbrella Provident Fund on resignation or dismissal from employment. Members who resign after 1 March 2021 will still be able to take their total retirement savings as a cash lump sum. Similarly, members who become paid-up members after 1 March 2021 will still be able to take their full paid-up benefit as a cash lump sum, provided it is before their normal retirement age.

Impact on benefit deductions and/or reductions

The permissible deductions from the retirement savings of members are listed in two pieces of legislation, namely the Pension Funds Act and the Income Tax Act.

Permissible deductions under section 37D of the Pension Funds Act are amounts due for housing loans, pension interest allocations when the member gets divorced, maintenance claims, compensation for damages to an employer, normal tax due to SARS and any arrear tax amounts. In terms of the Taxation Laws Amendment Act of 2021, only deductions allowed for under section 37D of the Pension Funds Act may be applied to proportionally reduce a member's vested and non-vested benefits. For example, a member has a vested benefit of R70 000 and a non-vested benefit of R30 000 **in the FundsAtWork Umbrella Provident Fund.** The member has a divorce order deduction of R50 00. The Fund will deduct 70% from the vested benefit (that is R35 000) and 30% (that is R15 000), from the non-vested benefit.

The Income Tax Act provides for partial pre-retirement withdrawals from a pension or provident fund on termination of service, i.e. when a member resigns from their employer and decides to take a portion of the withdrawal benefit as cash and transfer the remainder to their new employer's fund or a preservation or retirement annuity fund. Unfortunately, the Taxation Laws Amendment Act of 2020 does not specify the method to be used to deduct this pre-retirement withdrawal. National Treasury confirmed that the proportional split between the vested and non-vested benefits is limited to deductions permitted under section 37D of the Pension Funds Act and does not apply to any pre-retirement withdrawal benefit. As there is no legislative requirement on how to deal with this type of deduction, a decision was taken to follow an approach that is beneficial to the member, that is to deduct the total amount of the pre-retirement withdrawal from the member's non-vested benefit and only once depleted, from the member's vested benefit.

The cost of administration, premiums for approved insurance benefits and any other fund-related expense or fee will be deducted from the monthly contributions paid to the FundsAtWork Umbrella Provident Fund. If for any reason contributions stop in terms of the rules of the FundsAtWork Umbrella Provident Fund, and the rules allow for any of these costs to be deducted from the member's retirement savings, they will be deducted from the member's non-vested benefit.

Impact on transfers between funds

- A member's vested benefit and non-vested benefit that are transferred by the FundsAtWork Umbrella Provident Fund to any other fund(s) after 1 March 2021 will retain the vested and non-vested nature in the new fund(s) irrespective of how many times they are subsequently transferred to other funds and irrespective of the type of fund they are transferred to.
- From 1 March 2021, a member will be able to transfer between a pension and provident fund and vice versa without incurring any tax liability.

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03/2021