DEFINED CONTRIBUTION FUND TAX CHANGES
PENSION, PROVIDENT AND RETIREMENT ANNUITY FUNDS

WHAT IS THE "R247,500 LIMIT"?

In some circumstances, members of retirement funds will not be required to use some of their money to buy a pension income at retirement.

> *For members of pension and retirement annuity funds, there has always been a limit on the amount of money they must build up before it is compulsory to buy a pension at retirement – this limit will increase from 1 March 2016.*
>
> *For members of provident funds, the same structure will apply for the first time from 1 March 2016.*

BACKGROUND

The Income Tax Act requires that on retirement from defined contribution pension and retirement annuity funds, no more than one third of the value of a member's benefit can be taken in cash. The balance, i.e. at least two thirds of the benefit, must be used to provide a pension income for the retired member.

There is however an exception to this requirement: in cases where the value of the benefit is small, the Act allows the full benefit to be taken in cash. The reason for this is believed to be to avoid a situation where the pension income is very low, and likely to be unreasonably reduced due to costs when purchasing an annuity/pension from an insurer.

From time to time this "full-cash limit" is reviewed as part of the national budget process.

LIMIT REVISED FROM 1 MARCH 2016

From 1 March 2016 the limit will be R247,500 – if your fund value does not exceed this amount then you have the option to take it all as a cash lump sum on retirement, subject to tax as always, of course.

NEW SITUATION FOR PROVIDENT FUND MEMBERS

One of the changes that is being introduced from 1 March 2016 as part of the retirement tax reform process is that in future, provident fund contributions will be treated the same as those made to pension and retirement annuity funds.

It is important to know that all existing provident fund balances for members as at 29 February 2016 will retain their old lump-sum status – members will always be able to take those amounts, plus all future investment growth thereon, in full as a lump sum on retirement from a provident fund.

Provident fund credits that build up from contributions made after 29 February 2016 will, however, in future be subject to the same rules as for pension and retirement annuity fund members: at least two thirds must be used to provide a pension income on retirement.

Important note: provident fund members who are aged 55 or over on 1 March 2016 will still be able to take their full fund credit in cash at retirement if they remain in the same provident fund.

How does this tie in with the R247,500 limit?

The answer is that provident fund contributions made after February 2016 plus investment growth thereon, will be tested against the same full-cash limit on retirement. If it amounts to no more than R247,500 then it can be taken as a full cash lump sum benefit.

REACHING THE LIMIT

In practice, different members will take different lengths of time to accumulate R247,500 from 1 March 2016 onwards. Lower paid members and/or members with low net retirement contribution rates may take many years to reach that amount, whereas higher earners and/or higher contributing members will reach it more quickly. The rate of investment growth that is added to your fund credit will also impact on how fast you reach the limit.

This is an important point because members of most provident funds are allowed to retire from the fund if they leave employment before normal retirement age at any time after reaching age 55 – this is called 'early retirement'. Such members who are under age 55 on 1 March 2016 need to keep this in mind as it is possible that if they take early retirement after attaining age 55, they may still be able to take their whole benefit in cash. The pre-1 March 2016 fund credit plus investment growth thereon can be taken in cash because that right is enshrined in the law. And if the amount built up after that date does not exceed R247,500 then it too can be taken as a full cash lump sum.

CONCLUSION

It is usually advisable for people to use their fund savings to provide an income after retirement – this is because during our working lives we have learned to live from one pay day to the next and to budget and manage our money accordingly.

The fact that you are able to take your full capital in cash at retirement certainly doesn't mean that is the right thing to do. It does however allow you to plan appropriately based on your needs.

Each taxpayer's circumstances will be different and members are advised to seek expert financial planning advice when making decisions about their retirement savings arrangements.

Your Robson Savage consultant will be glad to provide any further input you might require.

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