Proposed changes to retirement funds created confusion

By Cindy Wilson and David Crossley

21 Jan 2015

Government's proposed legislative changes to current retirement funds have created a great deal of controversy and confusion in the market, with some individuals going so far as to resign from their jobs in order to cash-in and 'protect' their provident fund savings. This is based on the mistaken belief that government will not allow members to access their benefits once these changes are implemented. In fact, nothing could be further from the truth.

© Fotolia.com

With many South Africans poorly prepared for retirement, government recently announced its proposed changes to legislation regarding retirement funds. The intention behind these changes is to encourage people to save more for their retirement and to make this process as simple and as tax effective as possible. The announcement however, has unfortunately created a lot of confusion and panic among the public with all changes now being delayed by National Treasury for possibly two years.

That being said, it is likely that these changes will still be implemented at a future date, making it important to understand the impact on your retirement portfolio:

- Employer contributions to retirement funds will be taxed as fringe benefits in the hands of employees. The employee may then deduct up to 27.5% of total remuneration in respect of contributions (employer and yours as employee) to pension, provident and retirement annuity funds, subject to an annual cap of R350,000.
- Members' options on retirement, if we accept that the purpose of saving for retirement is to create a regular income when we retire, then it stands to reason that there should be a limit to the lump sum that can be cashed in when reaching retirement age.
- Provident funds will align with pension and retirement annuity funds, and all will be subject to the same taxation regime. At retirement, a third of your fund's value can be taken as a lump sum, while two thirds must be used to buy retirement income, regardless of whether the source of funds is a provident or pension fund. This will, however, only apply to contributions paid after the implementation date on provident funds. It will not apply to the value you have in the provident fund at the implementation date (plus future growth on this value).

This value may still be paid as a lump sum going forward and will not be subject to the one third limit that applies to contributions after implementation date (members of provident funds above the age of 55 at the implementation date will also still enjoy full access to their full benefit at retirement).

- Commutation threshold upon retirement will be increased from R75,000 to R150,000 for all retirement funds. This means that if your retirement benefit is R150,000 or less, you will be allowed to take your whole benefit as a cash lump sum. You will not have to buy a pension with at least two thirds of your benefit.
- Tax-free portability of retirement funds will be introduced. Fund benefits will be capable of being transferred between all retirement and preservation funds tax-free. In particular, transfers from pension funds and retirement annuities to provident funds will now be tax-free.

It is important to note that you will still be allowed to take your withdrawal benefits in cash. You also won't be required to keep your withdrawal benefits in a retirement fund when you change employers. Compulsory preservation of retirement benefits has not been implemented.

Perhaps the most important thing to be aware of however, is that government has stated that it does not intend to take control of or nationalise any pension funds. Its aim is rather to encourage all of us to take ownership of our retirement plans, and preserve and grow our wealth to make these plans possible.

ABOUT THE AUTHOR

Cindy Wilson is a director in BDO Employee Benefits and David Crossley is a practice manager in BDO Wealth Advisers.