MEMBER OPTIONS WHEN LEAVING
A DEFINED CONTRIBUTION RETIREMENT FUND

This note contains a summary of the normal options available to members who leave an employer's retirement fund, and the resulting tax consequences.

The importance of preserving your benefits if possible and taking proper financial advice are stressed.

INTRODUCTION

Many people are fortunate to spend at least some of their lives working and during that time, hopefully saving for retirement. When you leave a defined contribution retirement fund a number of decisions need to be made, however, it must be noted that the choices differ depending on the reason for leaving the fund / employment:

- On retirement:
  - How much money to take In cash; and
  - What type of pension to buy with the balance of the benefit.
- On any other type of exit:
  - Whether to preserve your money for your eventual retirement, to take it in cash, or preserve some and take the balance in cash.

When making these decisions, you need to consider your own unique personal financial circumstances and the risks attached to the different options.

There is no one-size-fits-all withdrawal or retirement option that will work in every situation for every person and it is therefore important that you seek professional financial advice to ensure that you make decisions that are in your own best interests.

Different conditions apply depending on whether you were a member of a pension or a provident fund, and these are explained below.

This document provides a brief guide to the options that are normally available when you exit a retirement fund, but please bear in mind that the actual details will be governed by the rules of the fund as reflected on your most recent benefit statement.

Please refer to the end of the document where various terms and expressions are explained in a brief glossary.

If you are a member of a defined benefit fund then different considerations may apply and appropriate advice would need to be obtained.

1. CHOICES WHEN LEAVING SERVICE BEFORE RETIREMENT DATE

If you leave service before you retire, the following options are available to you.

1.1 Transfer your fund credit to another retirement fund

You can preserve your benefit by transferring your fund credit to another retirement fund. Some examples are:

- To another approved pension or provident fund, including the fund offered by your new employer; or
- To a retirement annuity fund; or
- To a pension preservation or provident preservation fund, if you are transferring from a **provident** fund. If you are transferring from a **pension** fund, you can only transfer to a pension preservation fund.

The merits of preserving your benefits for when you eventually retire cannot be overemphasised.

Attention is drawn to further comments regarding preservation in section 4 below.

Tax is not payable on the amount transferred at the time but will be payable when you eventually receive your benefit from any fund. The one exception to this is a transfer from a pension to a provident fund, which would be taxed in full at the time.

1.2 Take your benefit in cash

On exit you can elect to receive your full fund credit in cash (excluding any amount owed by you through your fund for a housing loan, divorce order, maintenance order, etc. some of which may have been paid before your exit date).

Taking your benefit in cash may, however, have a serious negative effect on your eventual retirement benefit.

Any member contributions made to the fund with after-tax money (for example, member contributions to a provident fund prior to 1 March 2016) will be paid out tax-free. Any employer and member contributions paid with pre-tax money and investment growth on all contributions will be subject to tax.

Your fund administrator will supply SARS with the relevant fund data for them to calculate the correct amount of tax payable.

The calculation of the tax payable on a cash withdrawal benefit in the tax year ending 28 February 2018 is as follows:

Table A

Taxable income from lump sum withdrawal	Tax payable
R0 - R25 000	R0
R25 001 - R660 000	18% of amount exceeding R25 000
R660 001 - R990 000	R114 300 + 27% of amount exceeding R660 000
R990 001 and above	R203 400 + 36% of amount exceeding R990 000

 # This table is correct at the time of writing but may change from time to time. Please consult your Robson Savage consultant or visit www.robsav.com for an up-to-date tax calculator.

Note: These tax rates apply cumulatively over your lifetime, covering all withdrawal benefits from all retirement funds (pension, provident and preservation funds) from 1 March 2009.

Special note regarding retrenchment: please refer to section 3 below where the taxation of benefits on retrenchment is set out.

1.3 Preserve part and take part in cash

It may suit you to take some of your benefit in cash and preserve the balance.

In this case tax is calculated as explained above for each portion of your benefit, i.e. tax-free for the portion preserved and according to the table for the cash amount.

2. CHOICES AT RETIREMENT (FROM AGE 55 ONWARDS)

If you are over age 55 you can elect that your exit from a fund is dealt with as a retirement. This can be early retirement (before your employer's/fund's normal retirement date. You may need your employer's agreement), normal retirement or late retirement (after normal retirement date, if the fund's rules allow this). You can also retire through ill-health at any time before normal retirement date if the reason you are retiring is that you are totally and permanently unable to work.

2.1 Accrual date of retirement benefits

From 1 March 2015, the Income Tax Act was amended so that retirement benefits accrue to members on the date that they elect to retire from their fund, independently of when they retire from the service of their employer. Tax will be calculated using the applicable rates and the benefit value on the date the member chooses to retire from the fund.

Members can if they wish, therefore postpone retirement from the fund even though retirement from service has already taken place. This allows members to take control of when the retirement benefit is paid, permitting their personal circumstances and financial planning needs to be taken into account.

2.2 Take a cash amount

If you are retiring from a **provident fund**, you will be entitled to:

- take the full amount of your fund credit in cash;
- take a portion in cash and use the balance to buy a pension; or
- use the full amount to buy a pension.

If you are retiring from a **pension fund,** you will be entitled to:

- take the full amount of your fund credit in cash only if your gross benefit does not exceed R247,500.00.
- if your gross benefit is more than R247,500.00 then you can take up to 1/3rd of your fund credit in cash and the balance must be used to buy a pension.

The choices regarding buying a pension are explained further below.

The calculation of the tax payable on any amount taken in cash at retirement in the tax year ending 28 February 2018 is as follows:

Table B

Taxable income from lump sum retirement, involuntary retrenchment or death benefits	**Tax payable**
R0 – R500 000	R0
R500 001 – R700 000	18% of amount exceeding R500 000
R700 001 – R1 050 000	R36 000 + 27% of amount exceeding R700 000
R1 050 001 and above	R130 500 + 36% of amount exceeding R1 050 000

 # This table is correct at the time of writing but may change from time to time. Please consult your Robson Savage consultant or visit www.robsav.com for an up-to-date tax calculator.

Note: These tax rates apply cumulatively over your lifetime, covering all retirement benefits from all retirement funds (pension, provident, preservation and retirement annuity funds) from 1 October 2007. In addition, any contributions made to a fund which were not previously allowed as a tax deduction, will be added to the tax-free amount.

2.3 Purchasing a pension

There are **two** different types of pension that can be bought with the amount of your retirement benefit that you do not take in cash.

2.3.1 Pension for life from an insurance company

The insurer is paid the money when you retire in exchange for them paying a regular monthly income to you for life. This type of pension can be bought with various “add-on” options such as annual pension increases, a guarantee that the pension will continue to be paid for an agreed minimum period of time even if the pensioner should die, a pension payable for life to a spouse in the event of the pensioner’s death, and a lump sum payable on the pensioner’s death. The monthly pension payments are subject to normal income tax.

It is recommended that you obtain quotations from various insurance companies to allow you to secure the best value and also to assess the available add-ons and their cost. A professional financial planner is invaluable when obtaining such quotations, but care should be taken to establish any commissions or fees payable and to negotiate these where appropriate.

The key features of an insured pension are:

- The pension is payable by the insurance company for as long as you live. The insurer thus takes on the risks associated with making the pension payments each month, including the situation where you live to a ripe old age. This can be very reassuring for a pensioner especially if there is no other source of income to fall back on.

- The pension payments end when the pensioner dies (subject to any add-ons that you may have elected – see above). There is thus no remaining investment value to be paid to your heirs and it is important that this is understood.

2.3.2 Living annuity from an insurance company or other financial service provider

Your retirement money is invested in an investment portfolio of your choice and this is treated as your own “pension account”. The pensioner “draws down” from the account by receiving an amount each month as a pension, between limits of 2.5% and 17.5% of the value of the remaining capital. These limits are set by the tax authorities and may change from time to time. The draw down rate can be changed annually, and monthly pension payments are subject to normal income tax. The investment portfolio can usually be changed from time to time, perhaps subject to the payment of a fee. This may be important, as it is possible that the pensioner’s investment risk profile may change over time.

The account is regularly adjusted to reflect investment returns (positive or negative) and reduces through fees and the pension payments. This means that you, the pensioner, take the investment risk and payments are therefore not guaranteed. It is imperative that this is understood.

The key features of this option are:

- The money can run out while the pensioner lives on. The success of a living annuity in meeting a pensioner’s financial needs depends on the investment returns earned and the draw down rate. If the investments underperform and/or the draw down rate is too high then the capital can be depleted to where it will no longer provide the income that the pensioner was hoping for, or indeed needs for survival. Conversely, if the investments perform well and the draw down rate is properly managed, a living annuity can be a successful means of arranging a pension. The pensioner thus carries the key risks and it is very important that this is understood. This may suit someone for whom there is a “Plan B” in terms of other assets or sources of income in case the living annuity does not work out as planned.
- The pensioner has to take steps to ensure that there will be someone to carry on making the key decisions regarding investment portfolios and draw down rates, even when they become unable to make these decisions themselves.
- This is often achieved by paying for the services of a financial planner on an ongoing basis. Whilst such a service can be very valuable, care must be taken to understand fully the fees involved and to negotiate these where possible.
- On the pensioner’s death the remaining assets are payable to the dependants or nominees of the pensioner.
- A living annuity can be later converted to a guaranteed annuity but not after age 80. This can be a useful feature if for example insurance company pensions are expensive at the time of retirement, such as would be the case if interest rates are low. When the interest rate cycle has moved up again and pensions are cheaper, the remaining living annuity capital can then be used to secure an insured pension on better terms. Each person’s circumstances are unique, however, and your decisions must be based on your own situation at the time.

3. CHOICES ON RETRENCHMENT

In the event of retrenchment the following options are available:

- If you are a member of a pension fund you may transfer your benefit tax-free to a pension preservation fund;
- If you a member of a provident fund you may transfer your benefit tax-free to a provident preservation fund or pension preservation fund;
- You may elect to transfer your benefit to a retirement annuity fund, tax-free;
- You may elect to transfer your benefit to your new employer's pension or provident fund, provided the rules of both funds permit this; such transfers are tax-free except from a pension to a provident fund, which is taxed in full – this needs to be borne in mind;
- You may elect to take your retrenchment benefit in full as a cash lump sum, subject to tax as explained below.
- You may elect to take part of your benefit in cash, subject to tax as explained below, and transfer the balance to another fund.

If the reason for your retrenchment is because either:

- Your employer is ceasing to carry on the trade in which you are employed; or
- As part of a general reduction in personnel,

then unless you owned at least 5% of the company, members can elect to have their cash fund benefits taxed according to the preferential table B (section 2.2 above).

If your employer gives you a retrenchment benefit tax-free outside of the fund, that amount will reduce the amount that can be received tax-free from the fund.

4. VARIOUS ISSUES

4.1 Transferring to a preservation fund

If you choose to transfer to a preservation fund in your name, the following advantages and disadvantages should be noted:

	Advantages	Disadvantages
1.	You are allowed one withdrawal from the preservation fund in part or full between the time the money is transferred and when you retire. Any divorce, maintenance, tax or housing loan deductions will not be construed as this one withdrawal from your fund when transferring to a preservation fund. This feature can give you comfort that you can access money from the fund should the need arise.	It can be considered a disadvantage to be able to access some or all of your money as a once-off withdrawal from the preservation fund, as this action will reduce your retirement savings.
2.	You will not pay any tax at the time of transfer to the preservation fund as tax is deferred until you	You cannot make further regular contributions to a preservation fund

	access your money at a later time.	(although you can transfer other exit benefit entitlements when you leave other funds during your working life).
3.	You may choose and switch investment portfolios while your money remains in the preservation fund according to the rules and terms and conditions of the fund you have chosen.	Care must be taken to understand any charges or commissions that might become payable in the event of changing investments.
4.	You can consolidate your retirement fund benefits in one preservation fund during your working life, thus simplifying your financial arrangements.	Any cash withdrawal from your preservation fund (whether partial or full) will be taxed as per tax table A in section 1.2 above.

4.2 Transferring to a retirement annuity fund

If you choose to transfer to a retirement annuity fund in your name, the following advantages and disadvantages should be noted:

	Advantages	**Disadvantage**
1.	Your fund benefit cannot be accessed until it is taken as a retirement benefit after reaching age 55.	No withdrawals are allowed until retirement. This is not always a disadvantage as it ensures your money is preserved for your retirement.
2.	You will not pay any tax at the time of transfer to the retirement annuity fund as tax is deferred until you access your money on retirement at a later date when tax will be based on table B in section 2.2 above.	This can be a relatively expensive option and care must therefore be taken to understand the expenses involved.
3.	You can make further contributions to a retirement annuity fund.	
4.	You may choose and switch investment portfolios according to the rules and terms and conditions of the fund you have chosen.	Care must be taken to understand any charges or commissions that might become payable in the event of changing investments.
5.	At retirement up to one-third of your benefit can be taken as cash while the other two-thirds must be used to buy a monthly pension, even if your money was transferred to your retirement annuity fund from a provident fund.	
6.	You can consolidate your retirement fund benefits in one retirement annuity fund during your working life, thus simplifying your financial arrangements.	

4.3 Unclaimed benefits

An exit benefit is deemed to accrue for tax purposes:

- on the date the member elects to have the benefit paid;
- on the date on which the benefit is transferred to another fund or
- on the date of death.

A benefit can be considered to be "unclaimed" if it has not been paid to a member 24 months after exit date. The trustees of the fund may transfer "unclaimed" benefits tax-free into an unclaimed benefits preservation fund.

It is the member's responsibility to be sure to give instructions in good time on what the fund should do with the benefit payable.

4.4 Life insurance and disability insurance cover

On leaving service before normal retirement date, your employment-related group insured risk benefit covers will cease. These could include benefits such as death, disability and family funeral benefits, and should have been communicated to you while you were working. Some policies might be fund-owned and some employer-owned.

Depending on the terms of the applicable insurance policy you may be able to convert all (or some) of the group insurance cover into a new individual life insurance policy at ordinary premium rates for your age, gender, smoker status, education and occupation, without limited or no medical examinations. This is called a "conversion option".

The actual terms on which the conversion option is granted may vary somewhat from insurer to insurer and policy to policy, and you should enquire about the details at the time when you are leaving the fund.

People who are otherwise uninsurable or only insurable with a heavy health loading on their premiums should seriously consider the opportunity to take up such a "conversion option" if it is available to you.

You should seek proper, professional financial advice to assess your true needs for the cover, the costs, the types of policies that can be set up and so forth.

The "conversion option" facility, where available, may be most important if you are not going to other formal employment where there are new, employer-sponsored or in-fund insurance benefits to take the place of previous cover.

It is important to note that, where this option is available to you, there will be a limited time to take it up, typically 30 or 60 days after exiting service / the fund and, while you are deciding whether to take up the option (if available) or not, you may still be covered by the insurer. Each insurer has different terms and conditions and you should enquire about this at the time.

4.5 Advice from a Certified Financial Planner

When you are entitled to receive a benefit from a fund, make sure that you seek professional financial advice to ensure that you understand all the options available to you.

You also need to take professional advice to establish the tax position regarding your benefits, especially as the tax rules change from time to time and may be different to what is reflected in this document.

It cannot be stressed enough that it is important to consult with a Certified Financial Planner. This is because each person's financial circumstances are different and you need to make sure that your own particulars are taken into account when making your decision. If you do not already have your own planner, Robson Savage would be glad to assist you. Alternatively you can find a list of qualified planners on the Financial Planning Institute of Southern Africa Website – www.fpi.co.za.

The Financial Services Board also oversees important legislation to protect you and improve the quality of advice given by financial service providers. Remember, the decision is your own therefore it is important that you make sure that the financial planner is properly registered with the Financial Services Board.

5. GLOSSARY OF TERMS

Annuity	Another word for 'pension'.
Defined benefit fund	A fund where the benefit received by a member is calculated by a formula set out in the fund's rules, usually based on length of service and salary.
Defined contribution fund	A fund where the benefit received by a member is calculated from the contributions paid into the fund on the member's behalf, reduced for expenses and insurance premiums and adjusted to reflect investment returns. This is the most common fund structure in South Africa today.
Fund credit	The contributions paid into the fund on the member's behalf, reduced for expenses and insurance premiums and adjusted to reflect investment returns. You can think of your 'fund credit' as being your pot of savings money in the fund.
Preservation fund	A special type of retirement fund in which you can invest the retirement savings benefits that become payable to you from pension or provident funds when you leave the service of employers during your working life.
Risk benefits	Benefits payable on death or disability, that are usually provided through an insurance policy taken out by your retirement fund or employer.

Disclaimer: *This document is issued for general information and as factual guide and explanatory note. It is not intended as a substitute for legal or financial advice which fund members are encouraged to seek at the appropriate time. The information supplied herein is up-to-date for the tax year ending February 2018.*

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