



HOW DOES A RETIREMENT ANNUITY WORK:

What is a Retirement Annuity (RA)?

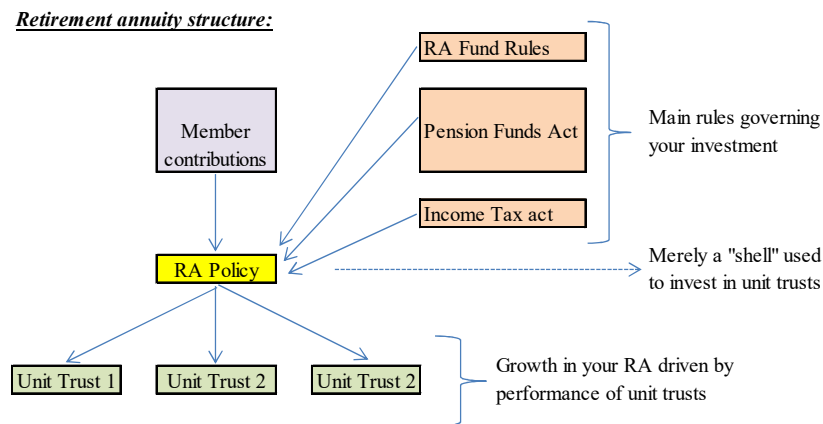
A retirement annuity is a regulated scheme to help you save for your retirement. It requires you to contribute a certain amount to the fund during your working life. On retirement the fund pays out 1/3 of your savings (plus growth) in cash with the remaining 2/3 being invested in a vehicle that provides you with a monthly annuity for the rest of your life.

All retirement annuities are governed by the Pensions Fund Act 24 of 1956. Unlike a pension or a provident fund, a retirement annuity is classified as an individual scheme which implies that employment is not a prerequisite for membership to the fund i.e. you don't need an employer to be part of a retirement annuity scheme. As such, changing employment does also not affect the status of your retirement annuity fund.

How is a Retirement Annuity structured?

When you purchase a retirement annuity, you basically join a retirement annuity fund and you need to abide by the Fund's rules. This fund then invests your monthly contributions in a portfolio of assets (unit trusts) as specified by you. So your RA is effectively a "shell" with certain rules that is used to direct your contributions to various unit trusts that are selected by you. The actual growth in your retirement annuity is then driven by the performance of these unit trusts. Additional contributions and withdrawals from these unit trusts are governed by the specific RA rules.

These unit trust investments have to fall within the fund rules and any other regulations.



How does a Retirement Annuity work?

During your working life:

During your working life you continue to contribute your set monthly amount to the RA fund. You can always top these contributions up with lump sum "capital injections" at any stage during the year and also increase or decrease (or even cease) your monthly contributions as and when you please.

You may not make any withdrawals from the retirement annuity before you reach the age of 55.

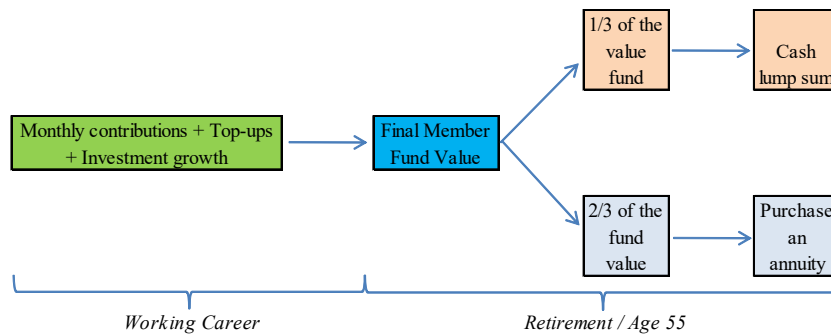


At maturity / age 55 / retirement:

You may retire from the RA at any stage from the age of 55. When you retire, you will be entitled to **take up to one-third of the value of your fund in cash only**. A minimum of two-thirds of the proceeds must be transferred into a life or living annuity from an insurer of your choice which is then used to provide you with some sort of monthly / annual income for the remainder of your life.

The revenue authorities do however allow you to take the full fund benefit amount as a lump sum in the following three scenarios:

- If the full fund value is less than R247,500; or
- Permanent disability; or
- If you are emigrating (this is a very important exception because it gives you that added comfort that you won't lose your RA contributions should you leave the country one day).



Why choose a Retirement Annuity over a simple investment?

The alternative to a RA is basically one of three strategies:

- a straight savings plan / fixed deposit type investment where your returns are limited to the rates offered by the banks / insurers; or
- investing the funds directly in unit trusts with such investment being totally discretionary i.e. not under the “banner” of a retirement annuity product; or
- using the money that you would have contributed to a RA in some sort of an entrepreneurial fashion to create wealth e.g. buy and sell property, open a business, buy and sell shares etc.

RA's offer you excellent investment exposure and also very favourable income tax deductions which are not available to simple investments. These “savings type” investments mentioned above also carry under-performance risk and also the risk of stagnation i.e. good intentions to put away money but never really doing it! This alone is reason enough to disregard bullet number one above if your savings are retirement orientated. The favourable tax deductions are discussed in more detail below.



In essence a discretionary unit trust investment (bullet no. 2 above) is structured very similarly and should perform exactly the same as a RA (if invested in the same unit trusts) but it will not qualify for the favourable tax deductions that RA's qualify for (discussed later in this document).

In reality, very few people have the drive, time, skill (and often blind luck) to create sufficient returns on their cash in a pure entrepreneurial fashion. This type of investment also carries huge risk (if you get to age 55 and your schemes have not paid off you are in big trouble!).

Your retirement annuity is protected in terms of the Pension Funds Act of 1956 and cannot be attached by your creditors should you be declared insolvent.

A retirement annuity thus offers you the following benefits:

- a disciplined method of saving;
- very favourable tax deductions (discussed below);
- exposure to a wide variety of investment funds and markets;
- protection from creditors;
- exposure to risk levels that suit your profile;
- flexibility (you can make additional capital injections into the RA, you can switch between the funds that you are invested in as and when you choose etc.);

What happens to my Retirement Annuity should I pass away before reaching the age of 55?

If you pass away while you are still a member of the Fund, the proceeds of your investment become available to your nominated beneficiary / beneficiaries. However, in terms of the Pension Funds Act, the Trustees are responsible for the fair and equitable distribution of the benefit among your dependants and nominated beneficiaries. For this reason the Trustees will take account of your nominations, but will not be bound by them as they are required to consider the needs of your legally defined dependants at the time of your death. In order for them to have the most relevant information on which to base their decisions, it is important for you to update your Beneficiary regularly.

In the event of the fund being furnished with a valid divorce order in respect of a member's investment, the Trustees will comply with the terms of the order and make payments to your ex-spouse as required.

Taxation implications of a retirement annuity

RA contributions during your working life:

Your RA contributions are tax deductible. The tax deduction in the year of contribution is capped at the greatest of the 27.5% of remuneration (i.e. your salary) or taxable income, with the total deduction being limited to R350,000 p.a.



The unclaimed portion of your contribution rolls-over to the following year. If at retirement there are still unclaimed contributions that have rolled over, these can be offset against the taxation payable on the 1/3 lump sum. Should the lump sum be tax free, the unclaimed portions can be deducted from any future taxable income. So at the end of the day all your RA contributions are deducted for income tax purposes in one way or the other.

Any growth on the capital value of your RA is currently tax free. In addition, switches between unit trusts within your RA will not trigger a capital gains tax event.

Lump sum at retirement (one third):

The lump sum taken at retirement will be taxed according to specific taxation rates as follows:

Retirement fund lump sum benefits or severance benefits	
Taxable income (R)	Rate of tax
1 - 550 000	0% of taxable income
550 001 - 770 000	18% of taxable income above 550 000
770 001 - 1 155 000	39 600 + 27% of taxable income above 770 000
1 155 001 and above	143 550 + 36% of taxable income above 1 155 000

Note that these rates are as per the current legislation and could change in the future.

Note that should the lump sum be withdrawn for any reason prior to retirement, it will be taxed according to a different set of taxation rates as follows:

Retirement fund lump sum withdrawal benefits	
Taxable income (R)	Rate of tax
1 - 27 500	0% of taxable income
27 501 - 726 000	18% of taxable income above 27 500
726 001 - 1 089 000	125 730 + 27% of taxable income above 726 000
1 089 001 and above	223 740 + 36% of taxable income above 1 089 000

Note that these rates are as per the current legislation and could change in the future.

Portion used to purchase an annuity (remaining two thirds):

The portion remaining after the lump sum withdrawal will be transferred to some sort of fund that will provide you with an annuity for the remainder of your life. This transfer to this fund is not taxable. You will however be taxed, at your normal individual tax rates, on the annuities received within any tax year i.e. you will be taxed on the income that this remaining amount generates and pays out to you.