RAs: THE FACTS

Retirement Annuities (RAs) seldom receive a warm welcome when mentioned in client meetings. They are perceived – rightly – to have been underperforming, inefficient savings vehicles. Yet they remain high on the list of estate planning tools recommended by trusted financial planners. **Why?**

Please read the 10 Questions & Answers below to find out more:

1. What Is An RA?

The RA is a personal pension fund. Like company pension and provident funds, RAs are governed by the Pension Funds Act. The RA itself is not an investment, it is a vehicle via which underlying investments such as unit trust funds and shares are accessed. This vehicle is ring-fenced from creditors and does not form part of the individual's estate. Treasury waives certain taxes on the RA but limits access to the fund value. An investor contributes on a recurring monthly or annual basis or as a lump sum.

2. Are There Different Types?

Yes. On one hand are Life Insurance- based RAs and on the other are new generation pure LISP (Linked Investment Service Provider) RAs. The former – which are still heavily marketed – are typically those which have returned poor results over the years and left many investors dissatisfied.

High administration fees and poor underlying fund options are to blame. The fees have been justified by product providers as necessary in order to pass along the costs of paying advisors upfront commission. This commission is also the reason surrender penalties are applied if contributions cease. Both the fees and penalties are unacceptable, so avoid these policies.

LISP RAs are not policies but pure investment funds and are the only type recommended by Consequence. Costs are lower, investment choice better and no surrender penalties can be applied. ***Be wary of advisors peddling Life Insurance RAs!***

3. What Are The Major Benefits?

A LISP RA is an effective investment platform from which to access the full range of asset classes. This is chiefly due to the significant tax and estate planning benefits which we will detail below. Also, the RA is an inherently disciplined way to invest over the long-term since the fund value cannot be accessed until age 55.

4. What Are The Tax Benefits?

The benefit is two-fold as the investor not only enjoys a zero rate of tax within the fund itself but also an annual income tax deduction of up to 15% of all non-pensionable income contributed to the fund. The example below illustrates the benefit of the deduction:

Client A has no company pension fund and an income of R300,000 pa. She would like to annually invest 15% of her income (R45,000) in unit trust funds for her retirement . What happens if she invests in unit trust funds: 1.) Directly or 2.) Via A Retirement Annuity fund?

	Direct		RA	
Income	R	300 000	R	300 000
Less Tax Deductible Contribution	R	-	R	45 000
Taxable Income	R	300 000	R	255 000
Tax Paid	R	55 495	R	43 495
Remainder	R	244 505	R	211 505
Amount Invested	R	45 000		
Remainder after tax and investment contribution	R	199 505	R	211 505

In both cases, Client A has paid her tax and invested R45,000 but because the RA contribution reduces her taxable income she is left with an additional R12,000.

5. What Are The Estate Planning Benefits?

Since the Retirement Annuity falls outside of the individual's estate, executors' fees and estate duty payable on death are avoided. It can be argued that the RA has many of the advantages of a testamentary trust. On death beneficiaries may receive the benefit as a monthly annuity or lump-sum. These amounts are taxed.

6. What Happens If I Stop Contributing?

If investing via a LISP platform there are no surrender penalties and the investment will grow within the fund until legally accessible. Contributions may be reinstated at any time. If investing via a Life Insurance policy there may well be a penalty if your advisor has accepted an upfront commission.

7. What If I Need Cash Now?

Your RA value may not be accessed until ages 55 unless you have emigrated, become disabled or if the value forms part of a divorce settlement. This is why we at CPW will always also recommend a complementary investment which is fully accessible to the client.

8. What Underlying Investment Options Do I Have?

All asset classes (equity, property, bonds and cash) are accessible. Regulation 28 of the Pension Funds Act limits the amount of risk pension fund investors are exposed to but given that share exposure may be as high as 75% and offshore exposure 25%, there remains scope for aggressive investment profiles.

A range of top fund managers are available on quality LISP platforms and some also offer direct share portfolios. Consequence will assist you in selecting a suitable underlying investment blend. Many RA investors contribute a fixed amount on a monthly basis. As prices drop so their contributions buy more units or shares. This averaging effect mitigates volatility but as value accumulates, closer management is required.

9. What Happens When/If I Access The Fund In Retirement?

Legislation was recently amended to the effect that benefits are no longer required to be 'matured' by age 70. Thus a client can build up significant value for future beneficiaries as per point 5 above without ever accessing the fund.

On maturing the RA, the client has the option of taking up to 1/3 of the fund value in cash. That amount is taxed as per the following table:

Taxable Income (R)	Rate of Tax (R)
0 - 315 000	0% of taxable income
315 001 - 630 000	18% of taxable income above 315 000
630 001 - 945 000	56 700 + 27% of taxable income above 630 000
945 001 and above	141 750 + 36% of taxable income above 945 000

The remainder must buy either a Linked or Life Annuity, both of which generate a monthly or annual income which is taxed at the annuitant's marginal tax rate.

The Life Annuity is the older type of annuity which pays a set amount until death. The downside here is that whilst a regular income is guaranteed, no residual amount can be left to beneficiaries.

A quality LISP Linked Annuity is the preferred option for those requiring investment options and the client may draw down an income annually of between 2.5% -17.5%. Like the RA, the 'LA' enjoys a zero rate of tax within the fund and does not form part of the investor's estate.

10. Is This The Only Investment I Need?

No. Fully accessible investments such as direct unit trust funds, ETFs or share and property portfolios should complement your RA.

WE HOPE THIS SHORT DOCUMENT HAS SHED SOME LIGHT ON THE TOPIC, PLEASE GO TO WWW.CONSEQUENCE.CO.ZA TO CONTACT US FOR FURTHER INFORMATION.

Address: 23 Lady Anne Ave, Newlands, Cape Town, 7700 **Phone:** 021 674 2222 **Cell:** 082 833 1875 **Fax:** 086 653 4999
Email: info@consequence.co.za **Web:** www.consequence.co.za
Consequence Private Wealth (Pty) Ltd (Registration Number 2009/005302/07)
Registered Financial Services Provider: 39659 **Directors**: Michael Furter, Jeff Middelmann