ACTUARIAL SOCIETY OF SOUTH AFRICA

QUANTIFYING RISK, ENABLING OPPORTUNITY

Retirement Matters Committee, sessional meeting Jan. 2016

The Taxation Laws Amendment Act, 2015 and regulations issued pursuant to the Act

Before we begin ….

We are not tax experts and what follows cannot be construed as us giving tax advice. This presentation simply represents our current understanding of what the recent tax changes mean for members, their retirement funds and their employer.

What legislation is relevant here:

1. Taxation Laws Amendment Act, 2014
   - Deals with the calculation of the fringe benefit value
   - Labour wanted TLAA 2015 to defer the implementation date of changes to provident funds (annuitisation at retirement)
2. Regulations on determination of fund member category
3. Regulations on information to be contained in contribution certificates
4. Section 11(k) of the Income Tax Act
   - Deals with allowable retirement fund deductions

- Also need to read the explanatory memoranda issued by NT

And what has changed?

1. Section 11(k) of Income Tax Act

   - Deductible subject to lesser of 27.5 percent of the maximum of remuneration / taxable income and R350,000 per annum
   - Harmonisation of the tax treatment of pension, provident and retirement annuity funds
   - So member contributions to provident funds now tax deductible
   - Whatever not tax deductible can be carried forward or will be tax free at retirement
   - Effective date: 1 March 2016

2. Paragraph 12D of the Seventh Schedule of Income Tax Act

- Value of employer contributions to a retirement fund is a fringe benefit for the purposes of calculating taxable income
- Value calculated as per the regulations
- Effective date: 1 March 2016

Calculation of fringe benefit value

1. Defined contribution funds, without any element of self insurance:
   - Actual contributions paid
   - But net off disability income costs and other unapproved risk benefits (incl. spouses, funeral) → already treated as fringe benefit (s12C)
   - NO contribution certificate required from the valuator.
2. Defined benefit funds, incl. DC funds with self insurance:
   - Fringe benefit value = A x B – C, where

     A = costs calculated by fund (see following slides)

     B = the retirement funding employment income of employee

     C = the sum of employee contributions to the fund

Defined benefit funds: valuation of four components

a. Defined benefit component factor: = A x B + C x D

- A = annuity accrual rate
- B = factor per table provided by regulations
- C = lump sum accrual rate
- D = 0.8

b. Risk benefit component factor: = A x B

- A = 0.5%
- B = capital value of average death in service benefits
- **Includes** refund of ARV or accum. cons (DB benefit) but not fund credit (DC benefit)
- **Excludes** any fully insured risk benefits → valued as DC benefit

Defined benefit funds: valuation of four components

c. Defined contribution component factor:

- Note: not referring to pure DC fund here; they don't need a certificate.
- Any DC rates specified in the rules for DB members
- Any fully insured risk benefits

d. Underpin component factor: $= A + B \times C$

- A = greater of DC and DB factors above
- B = 0.1
- C = lesser of DC and DB factors above

General comments

1. Applicable only to in service members, not pensioners
2. Employer fringe benefit value is independent of what is being paid to the fund
   - Surpluses and deficits do not affect the fringe benefit value
   - But the certificate must indicate what the employer is paying
3. Per NT the formulae are designed to “approximate the increase in value of … benefits … as a result of one additional year of service”
   - Averaging involved, incl. with split accrual and death benefits
   - There may be anomalies between members

Now to unpack some of this

1. Contribution certificates
2. Fund member categories
3. Defined benefit component factor
4. Risk benefit component factor
5. Other issues

1. Contribution certificates

- Separate contribution certificate to be provided by the fund to the employer for each “fund member category”
- Content but not format prescribed by regulations
- First one due 31 January 2016
- Unclear if certificate required in future if benefits do not change:

  para 12D(4): “*the board … must not provide a contribution certificate in respect of any year of assessment in respect of which those benefits remain unaltered subsequent to the issue of that contribution certificate.*”

  2014 explanatory memorandum: “*submit … each time that the fund submits their statutory actuarial valuations.*”

2. Fund member categories

- Fringe benefit values calculated across “fund member categories”
- Conditions for grouping in a category: (both conditions to be met)
  1. Benefits for that group of members determined by the same rules
  2. Same contributions paid or payable.
- Split accrual → will be only one fund member category
- In practice many funds will have one fund member category

3. Defined benefit component factor

- Different accrual rates

  Example: 2.0 percent ordinary members; 2.5 percent for executives

  - Must use different contribution categories

- Split accrual

  - Recall: will only be one fund member category
  - Simple (not salary weighted) average for increase in annuity benefits for the year of assessment
  - Cannot use average over potential future years to retirement

- Bonus service

  - Simple average increase in annuity benefits for the year of assessment

4. Risk benefit component factor

- In our experience the 0.5 percent factor is high for most funds
  - NT confirmed that it includes allowance for disability benefits
- If fully insured then the actual premium is used
  - Few DB funds fully insure risk benefits unless only provide lump sums
- Placing a value on spouses and children's pensions
  - "valuator's estimate of the average capital value of any spouse's pensions or dependant's annuities paid"
  - ie. no factors are being prescribed here
  - Need to make economic and demographic assumptions
  - Suggest consider using statutory valuation basis to avoid queries

4. Risk benefit component factor

- Must value refund of ARV or accum. cons if paid on death
  - Could be large for closed DB funds, members with long service
  - NT confirmed the DB annuity component factor allows for same q_x hence must value death benefit in the risk benefit component
- Our understanding: calculation done separately for each risk benefit
  - So: actual premium for fully insured portion *in DC portion*
    + 0.5% x [spouses + ARV or accum. cons] *in DB portion*
- DC funds with self insurance
  - Peculiar result: fringe benefit rate ≠ DC rates specified in the rules, as 0.5 percent unlikely to equal amount set aside by the fund
- Data: must use last statutory valuation or newer data

5. Other issues

- Does it make sense to contribute to a DC fund in excess of the R350,000 limit
  - Clearly would not want to limit your pensionable salary to a DB fund!
  - Would be an interesting actuarial research topic … tax free build up, institutional vs. retail investment fees, regulation 28 limitations
  - Soft factors include contractual savings vs. access to savings; protection from creditors; provisions of s37C

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Questions and answers