Business Accounting Network

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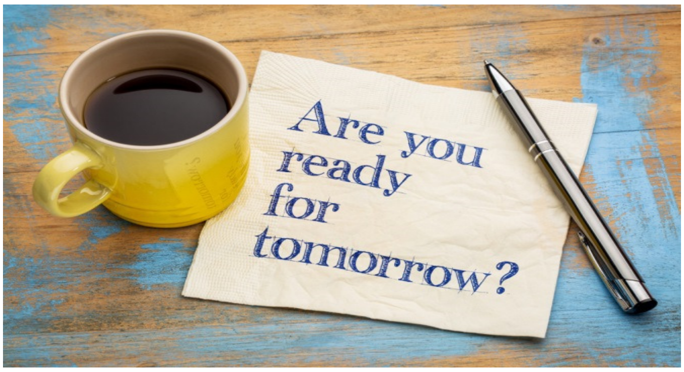
Going Beyond Accounting, Taking Business Forward



Is a Group Retirement Annuity the answer to your company's retirement planning?

By Stephen Cole

A recent Survey shows that South Africa is facing a dire retirement crisis, with 51% of our pensioners not able to pay their monthly bills and 33% unable to cover their medical expenses. Due to lack of discipline and/or procrastination by individuals, the onus to provide for retirement often falls on employers, with a large portion of retirement savings contributions being made through company sponsored schemes.

There are a number of savings options available to a company, one of which is a group retirement annuity (retirement annuities are also available to individual investors). This structure is not only convenient and uncomplicated, but can also be a cost-effective way to help employees save for retirement.

While employees will reap most of the reward for putting something away for retirement, employers could reap potential secondary benefits such as attracting better staff that often assess company retirement and benefits schemes, and enhancing productivity by improving morale among existing staff members.

THE GOOD, THE BAD AND THE NOT SO UGLY

Historically retirement annuities have only been available to individual investors, however, given the proliferation of Linked Investment Service Providers (LISPs) retirement annuities are now a viable alternative to traditional group retirement schemes, such as pension and provident funds. Like pension and provident funds, retirement annuities are a tax efficient retirement savings vehicle, with the following tax benefits consistent across all three structures:

I. Contributions are tax deductible – reduces tax payable in the year of contribution
II. Growth is tax free – No tax is paid on dividends, interest or capital gains.

Other key positive characteristics of Retirement Annuities include:

1. No maximum age for membership (therefore no force retirement from the fund),
2. Protection against creditors,
3. Excluded from the deceased estate calculation – reduces estate duty and executors fees.

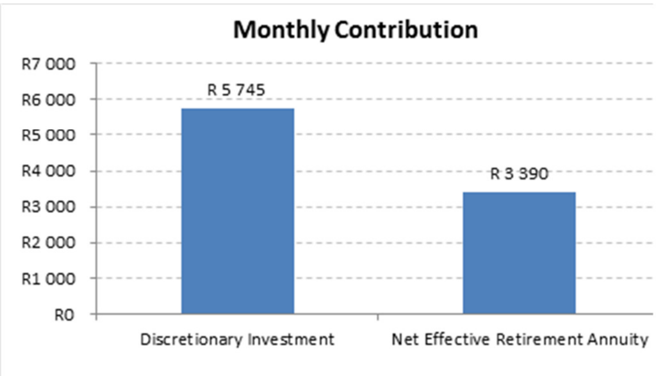
Retirement Annuities do have some shortcomings such as limited access to funds until the member is at least 55 years of age (although some might argue that this is in fact a beneficial attribute of RAs).

EXAMPLE

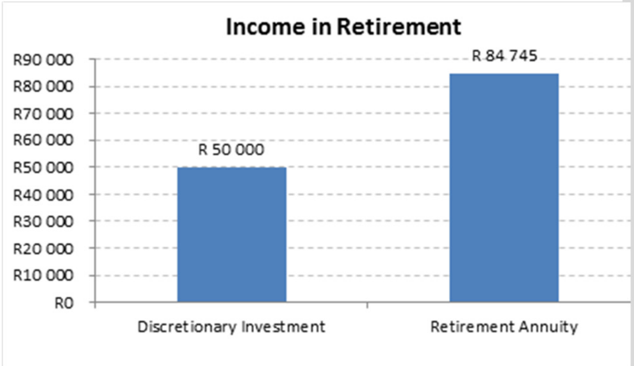
In the following example we will look at a hypothetical investor named Mark. Mark is 30 years old and plans to retire at the age of 65 on a monthly income of R50 000. He is relatively successful and currently earns R850 000 per year meaning his highest marginal tax rate is 41%. However, he has not started saving for retirement yet.

In order to achieve an appropriate portfolio value at retirement that will provide him with R50 000 per month, Mark will need to save R 5 745 per month in a standard discretionary investment. This is not an unreasonable amount given his relatively high salary; however Mark is not willing to sacrifice his current standard of living and would like to limit the amount he contributes to less than R3 500 after tax.

The only solution for Mark to meet all of his requirements is to contribute to a retirement annuity. This would effectively reduce his monthly after-tax contribution from R5 745 to R3 390 (as a result of the contribution being tax deductible).



Alternatively, Mark could decide that he will defer the tax benefit of his contribution by grossing up his monthly retirement annuity contribution to R9 737, meaning his effective after tax monthly contribution will be R5 745. By doing this, Mark will increase the income he is able to draw in retirement from R50 000, to R84 745.



Implementing a Group Retirement Annuity

When compared to some of the other investment structures, RAs are relatively simple, however it is often the simpler products that are most cost effective and therefore offer the greatest assistance in achieving a member's long-term financial objectives. This simple structure may also have the added benefit of reducing the administrative burden on the company when implementing and managing the scheme relative to more complex structures.

Despite the attractiveness of a group retirement annuity, no two companies have the same needs and circumstances, therefore the choice of which retirement vehicle, and if appropriate, which retirement annuity to use must be carefully considered. In our view, one should aim to compare solution across as many product providers as possible, focusing largely on:

1) Cost effectiveness and,

2) Underlying investment options.

For most companies (entrepreneurs), this analysis will fall outside the scope of the day-to-day activities of their business. We would suggest partnering with an independent financial advisor who can provide unbiased analysis of the various providers and solution to find the solution which best meets their needs.

Stephen Cole

Core Wealth Managers is a BAN alliance partner and wealth management firm that provides their clients with trustworthy advice and solutions for all their decisions regarding their wealth.