

## Retirement Fund Practice Note RF 1/96 (Calculation of flexible annuity benefits)

### SARS Practice Note RF 1/96

#### Calculation of flexible annuity benefits

The purpose of this practice note is to convey Inland Revenue's requirements for the payment of annuity benefits under living (flexible) annuity type arrangements.

An approved pension, provident or retirement annuity fund may provide a compulsory life annuity on a member's retirement from employment in one (or a combination) of two ways, namely by paying the annuity itself or by purchasing the annuity from a registered insurer.

The purpose of a compulsory annuity is to provide a life annuity for a member or an annuity for dependants or nominees of a deceased member.

While Inland Revenue has, in principle, no objection to flexible annuity arrangements, it has been noted that:

Certain life offices and companies are paying annuity benefits over a period of shorter than the annuitant's life time and are, in choosing to market such annuities, allowing annuitants the opportunity of taking an annuity income based on up to 40 % of the gross amount used to purchase an annuity. This is over and above provisions allowing the annuitant to still affect the maximum commutation benefit. This may produce an annuity which is not a life annuity.

Annuity income levels are being offered on the basis of a minimum income level of one (1) per cent or less which has the effect of deferring the accrual of taxable income.

In consultation with the various representative bodies of the pensions industry it has been decided to clearly define the parameters within which all flexible annuity arrangements must operate and to which all approved retirement funds or administrators must comply.

Conformance to the following set of parameters will, as a result, be required with effect from 30 June 1996 in respect of new flexible annuity arrangements or, in respect of flexible

arrangements already in operation prior to that date, with effect from the annual anniversary of the date of inception of the existing arrangement next following 30 June 1996:

The annuity consideration must be determined with reference to the net investment amount, less costs. Thus, where R100 000 was invested and costs were 5,5 per cent, the annuity will be calculated on the net amount of R94 500,00.

Flexible annuity benefits paid to an annuitant are to be reviewed on an annual basis. On the anniversary date of inception, the revised fund value will be required to be determined in order to calculate the minimum and maximum annuity benefits payable.

The income levels must be based on a minimum of five (5) per cent simple interest rate of return calculation and a maximum of twenty (20) per cent simple interest rate of return calculation, and must at all times produce a life annuity.

To determine whether or not a flexible annuity is in excess of R1800 for purposes of paragraph (c)(ii)(dd) of the definition of "pension fund" and paragraph (b)(ii) of the definition of "retirement annuity fund" in section 1 of the Income Tax Act, a minimum of eight (8) per cent simple interest rate of return calculation on the gross capital available for a member's retirement, i.e. before commutation, must be done. If, as an example, the gross capital, before any commutation, is R100 000, then 8% of R100 000 (being R8 000) is greater than R1800 and the gross capital may, as a result, not be commuted in full.

Flexible annuities provided on some other basis will not be recognised by Inland Revenue and funds providing such annuities will not be approved.

#### Example

Male aged 57; an investment amount of R105 820,11; a detailed overview of the minimum and maximum income levels payable:

Year 1 Annuity benefits are to be calculated on the nett annuity consideration

Minimum annuity benefit  
5 % x nett annuity consideration  
5 % x R94 500 = R4 725 paid annually  
or  
R393,75 monthly

Maximum annuity benefit  
20 % x nett annuity consideration  
20 % x R94 500 = R18 900 paid annually  
or  
R1 575 monthly

Year 2 The revised fund value based on a 15 % rate of return in the underlying portfolio

Minimum annuity benefit  
Revised fund value R106 682,68  
Revised annual annuity R5 434,13  
Revised monthly annuity R452,84

Maximum annuity benefit  
Revised fund value R93 661,38  
Revised annual annuity R18 732,78  
Revised monthly annuity R1 561,02

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