FUTURE FOCUS

SPRING EDITION 2023

INN8

INVEST

WELCOME TO FUTURE FOCUS

SPRING EDITION

Insights on building wealth for your clients.

Navigation

We hope you find relevant insights in this edition.

INN8 INVEST

TALKING POINT

Keep your eye on the horizon

Leigh Kohler
DFM Head: INN8 Invest

Key Points:

- The new 45% offshore limit is a game changer, placing more emphasis on specialisation and the experience of managing money offshore.
- The BIG themes that will impact the investment industry going forward – a sustainable world, technology (AI) and infrastructure.

Horses for courses

I was fortunate enough to spend a week in London in June where I attended investment conferences hosted by M&G Investments, Ninety One and Nedgroup Investments. Besides discovering that summer weather in London is great, one of my key learnings as a South African was that while we are truly blessed with access to great global fund managers right here in our back yard, there are only a handful of managers in SA with fully-fledged global capabilities.

Hence it remains important to 'kick the tyres' in the major economic hubs of the world to find the global managers that have demonstrated excellence in global markets. Since the relaxation of local exchange controls and subsequent changes to Regulation 28 offshore limits, it has become imperative for DFMs to reconsider how they perform portfolio construction. The problem is that not all DFM teams are equipped or experienced enough to take advantage of the opportunities that these changes have brought about. As a DFM with 25 years of portfolio construction experience and a well-resourced team of investment professionals, we recently introduced a hybrid approach to the construction of our model portfolio range.

> ...a hybrid approach to managing money

It combines the skill of the best South African managers running local-only funds with skilful global managers running global-only funds and a handful of managers that we believe have skill in both SA and abroad.

The BIG themes

Besides spending our time unearthing quality offshore managers in London, the three investment conferences, while unique and professional in their own way, all had three main underlying themes. Themes that are likely to impact the future of investment management.

The themes are:

A sustainable world

Innovation, technology and artificial intelligence (AI)

Infrastructure.

A sustainable world

The world is facing several sustainability challenges, including climate change, pollution and resource depletion. These challenges are having a significant impact on the global economy and financial markets.

TALKING POINT

Keep your eye on the horizon [cont.]

Investors are increasingly recognising the importance of sustainability – looking to invest in companies that are helping to address sustainability challenges and are well-positioned to thrive in a sustainable future, rather than companies that have, or may have, an adverse impact on the planet. While sustainable investing faces many challenges including 'greenwashing', it does not reduce the importance and potential impact of this investment theme. Although most SA managers are not able to express a pure sustainable investment view given the constraints and limitations on the JSE – insufficient listed companies to create a fully-fledged SA product that focuses on sustainability – there has been a focus and increased awareness locally on ESG.

In the UK and Europe this is a different matter entirely. Managers have geared their processes to bring ESG into the mainstream arena with a sizable movement of assets

...a different ball game offshore

into sustainable strategies. Managers such as Ninety One have been very vocal on their views around sustainable investing and can be considered leaders in this space.

Innovation, technology and AI

We all know that innovation is essential for economic growth and development. Technology and AI are two of the most important drivers of innovation today and are already having a significant impact on many industries. They are expected to play an even greater role in the global economy in the years to come.

"The development of AI is as fundamental as the creation of the microprocessor, the personal computer, the Internet and the cell phone" - Bill Gates

We have seen a big move from managers, both locally and globally, to introduce AI to their investment processes. While there have been strategies launched that are completely managed by machines, many managers are using or looking to use AI and machine learning to enhance client outcomes.

...the allure of AI in investing lies in its potential for finding new alpha

There are a number of ways for AI to add value beyond traditional (quantitative) investment methods – from overcoming human biases in investment decisions, to identifying new patterns in data and new forms of data analysis.

Scale will be critical to finance the technological infrastructure necessary to support AI – benefitting the larger managers. By contrast, small asset managers may not be able to afford to build the technology infrastructure and are expected to outsource this to specialist service providers. This would level the playing field for asset management and enable a broad array of firms to obtain the benefits of AI.

By way of an example, M&G is a large manager that has fully integrated AI into their global equity process. Both locally and globally, the manager has built an impressive team to develop the technology and continues to invest into AI as the technology evolves and adapts. AI investing also includes strategies that invest in companies that allocate capital to AI in the production process. Sands Capital and Janus Henderson are good examples of managers running these types of strategies.

Infrastructure

Investment in infrastructure is expected to grow significantly in the years to come and will be attributable to a number of factors – population growth, urbanisation, and the need to replace aging infrastructure. M&G noted that there has been insufficient investment in infrastructure both in SA and globally. The value that these projects could generate for investors, has the potential to be significant.

TALKING POINT

Keep your eye on the horizon [cont.]

Pay attention...the impact will be HUGE

The BIG themes are driven by powerful underlying forces that are likely to persist for many years to come. For example, climate change, technological change, and urbanisation are all long-term trends shaping the global economy.

They have the potential to create new industries and disrupt existing ones. For example, the rise of AI is leading to the development of new products and services, and is disrupting traditional industries such as finance and manufacturing.

They can offer investors attractive and differentiated alpha opportunities that can be 'bolted' onto traditional investments..

Investors that are able to identify and invest early in the BIG themes, have the potential to generate significant value over time. As a DFM, we have the team and experience to find the right managers, both locally and globally, that are building their business around these themes. Our hybrid approach towards investing allows us to bolt these thematic opportunities on to more traditional strategies and managers. We continue to keep our eyes on the horizon...because we have seen the change...and it is coming.

INVESTMENT CENTRE

Post retirement: investing in a living annuity

Joao Frasco
CIO

Key Points:

- Our research confirms the importance of setting the withdrawal rate lower to maximise the probability of success in retirement, recognising the need to balance this with the income needs of the pensioner.
- While higher risk solutions may not be necessary or even preferable at lower withdrawal rates, they are needed at higher withdrawal rates to improve the chances of a successful outcome.
- Making the 'right' decision on how much to withdraw at retirement is a complex task, influenced by many parameters and assumptions. It should begin with a conversation around the probabilities of success under different scenarios, as well as other options that are available to the pensioner now, and in the future.

How much to draw?

In SA living annuities are extensively used as a retirement wrapper. Often the most important questions that advisers and retirees have is how much they can draw from their savings to minimise their chance of running out of money. While taking the minimum of 2.5% may seem like the obvious answer, this needs to be balanced with income needs, especially since most South Africans do not retire with sufficient savings to meet their income needs. In addition, it is also important to consider how the retirement savings should be invested to support the income need and maximise the chance of not running out of capital.

In this article, we summarise the results of our research conducted on this topic and briefly touch on related topics such as bequests, the time to ruin, and 'bucket' strategies.

Methodology and assumptions

Very briefly, we used historical returns over the past 20 years, and a process called Monte Carlo simulations to generate many (100 000) possible future outcomes for a range of investment options – from 100% to 0% South African equities. We considered various withdrawal rates at inception, expressed as a percentage of the savings, and then maintained the real value of the income after that – completely ignoring the percentage after that and even allowing for breaches of the 2.5% to 17.5% limits.

We then considered two different questions.

- The FIRST was whether the capital would last a given period, ranging from 5 years to 35 years (in 5-year increments), ignoring mortality, which assumes that the retiree survives that long.
- The SECOND was whether the capital would outlast a male pensioner for ages ranging from 50 to 80 (also in 5-year increments), using South African mortality tables.

Life expectancy and survival probabilities

Let us first consider the life expectancy of South African male pensioners, along with the probability of them surviving a fixed period, given a specific age. Table 1, which follows, shows these results.

An important consideration when using the results for fixed periods, is what period should be used. You can see that for a 65-year-old, the life expectancy is around 15 years, but that there is a 5% probability of them living at least double that (30 years). If you wanted to have a high level of confidence in your money outliving you, you would want to use a longer period than your life expectancy.

If you were in ill-health, you may be happy to consider a shorter period, but you would need to recognise the risk you would be taking of running out of money before passing away.

INVESTMENT CENTRE

Post retirement: investing in a living annuity [cont.]

Table 1: Life expectancy and survival probabilities for a South African male pensioner.

Age	Life expectancy	Probablility of surviving (years)					
		5	10	15	20	25	30
50	24.0	90.9%	82.2%	72.9%	62.3%	50.0%	36.1%
55	21.2	90.4%	80.2%	68.6%	55.0%	39.7%	24.2%
60	18.1	88.7%	75.9%	60.9%	44.0%	26.8%	12.6%
65	15.1	85.5%	68.6%	49.5%	30.2%	14.2%	4.6%
70	12.3	80.2%	57.9%	35.3%	16.6%	5.4%	1.0%
75	9.6	72.2%	44.0%	20.7%	6.7%	1.3%	0.1%
80	7.4	61.0%	28.7%	9.3%	1.8%	0.2%	0.0%
85	5.5	47.1%	15.2%	2.9%	0.3%	0.0%	0.0%
90	4.1	32.2%	6.2%	0.6%	0.0%	0.0%	0.0%

Source: Liberty DFM, https://www.actuarialsociety.org.za/download/csi-pensioner-mortality-report-excel/

Probabilities of success

The results of the simulations were presented as a series of tables and charts that showed the probabilities of success (i.e., not running out of money) for the three dimensions (two at a time). Below we provide two examples, one from each of the two different methodologies.

Table 2 considers the probabilities of success over 25 years at different starting withdrawal rates for the four investment options considered.

It is interesting to note that low risk investment strategies are better (higher probabilities of success) at lower withdrawal rates, which implies you do not need to take on equity/market risk with your annuity if you have sufficient savings ('enough money') in retirement. Two important counterpoints, however, are that:

1) you are ignoring the bequest at the end of the period, which would clearly be expected to be higher for the riskier strategies; and

2) that the probabilities fall rapidly as the withdrawal rates increase and the probabilities of success are 0% at withdrawal rates of 7% and above (not visible in the table but included in the original research).

Table 2: Probability of success over 25 years

Period	25 years	All Share Index	SSA MA High Equity fund	SA MA Low Equity fund	SA IB Short Term fund
Withdrawal rate as a percentage of the initial investment	2.5%	99.5%	100.0%	100.0%	100.0%
	5.0%	89.9%	96.2%	97.8%	97.5%
	7.5%	63.6%	58.3%	16.3%	0.0%
	10.0%	35.6%	15.6%	0.0%	0.0%
	12.5%	16.1%	2.1%	0.0%	0.0%
	15.0%	6.4%	0.2%	0.0%	0.0%
	17.5%	2.4%	0.0%	0.0%	0.0%

Source: Liberty DFM

Table 3 considers the probabilities for a 65-year-old South African male pensioner. You should compare the results to Table 2 to note some important differences.

INVESTMENT CENTRE

Post retirement: investing in a living annuity [cont.]

The probabilities are generally higher because the probability always exists that the retiree will pass away before running out of savings. This raises the probabilities of success for riskier strategies because even though the chance of poor returns increases for these strategies, there is always the possibility of the pensioner dying early.

Table 3 Probability of success for South African male pensioner aged 65

Age	65	All Share Index	SA MA High Equity fund	SA MA Low Equity fund	SA IB Short Term fund
Withdrawal rate as a percentage of the initial investment	2.5%	99.8%	100.0%	100.0%	100.0%
	5.0%	95.9%	98.3%	98.0%	93.9%
	7.5%	83.1%	82.8%	69.6%	57.5%
	10.0%	65.1%	57.2%	43.7%	38.1%
	12.5%	16.1%	2.1%	0.0%	0.0%
	15.0%	35.7%	28.1%	24.3%	22.5%
	17.5%	27.2%	22.1%	19.8%	18.5%

Source: Liberty DFM

One of the most important results that should be apparent from both methodologies, is that at higher withdrawal rates, you should be taking on risk to improve your probability of success.

This is probably one of the biggest issues with pensioners that worry too much about sequence risk (the risk created by the combination of the 'sequence' in which returns are generated and withdrawals are made from a portfolio) and fail to take on enough risk to support a successful retirement outcome.

While sequence risk could lead to a poor outcome for riskier solutions, in many cases it is a superior strategy and has the added benefit of providing a higher bequest when the outcome is successful.

Other considerations and strategies

We have already mentioned one other consideration, beyond the probability of success or failure, which is the value of the savings at the end of the period or on death, that could be left as part of the estate as a bequest.

Another important consideration mentioned in the introduction, is how long your capital lasts before running out. If two options both had the same probability of success, you would prefer the option that lasted longer on average, in the case of failure. This is the subject of further research – keep an eye out for it, along with the research on the size of the legacy mentioned above.

Finally, another piece of research that we have conducted focuses on the 'bucket' approach adopted by many living annuitants. Essentially, the logic is that you have a portion of your savings in a secure liquidity bucket, to reduce the need to crystalise losses in your growth portion, thus addressing sequence risk. The results are fascinating and important. We will cover them in a separate article, highlighting that there is a difference between naïve rebalancing strategies and 'intelligent' strategies that carefully address sequence risk.

Conclusion

How much pensioners can withdraw from their living annuities is an important question that advisers need to advise their clients on. Beyond research into this important topic, advisers have an urgent need for tools that will allow them to understand the probabilities of success or failure under many different parameters and assumptions. Deciding on the 'safe' level requires an understanding of how these factors affect the probabilities and what level of probability should be targeted. Another important consideration is how savings should be invested to improve these probabilities, and specifically how the outcomes are affected when enough risk is not taken.

We will continue to conduct and report on research related to these important issues.

MANAGER INSIGHTS

Championing change: ESG scorecards

Jennifer Henry
Deputy Chief Investment Officer

Imelda Watkins
Portfolio Manager

Key Points:

- The inclusion of ESG into investment decision making has become more involved with better adoption of policies, data and expansion into environmental and social impact analysis.
- We have created a balanced ESG scorecard that allows us to make informed decisions on manager progress.
- Gaps remain around transformation and more holistic stakeholder engagement.

ESG and investment decision making

Changes in weather patterns and the impact on food security is tangible to everyone. Using this example, one can demonstrate how and why the relationship between the environment and ESG (Environmental, Social and Governance) investing is starting to resonate more broadly with investors.

Aside from having financial security, a retiree would want good quality breathable air, a clean sustainable environment, a well-balanced society that embraces them and their children; with the knowledge that good governance is at the core of all organisations whether they are public or private institutions. It is therefore imperative for us as a DFM to ensure ESG considerations are well-entrenched in our investment decision-making processes – assisting us and our investors to influence the way companies are managed as good corporate citizens.

Global regulation to date has played a pivotal role with the integration of ESG into investment decision making. The Principles for Responsible Investing (PRI) in 2005 and adoption of the 17 Sustainable Development Goals (SDGs), established comprehensive frameworks and measurable targets for global sustainable development.

In SA, the Code for Responsible Investing (CRISA 2) provides guidance on how institutional investors should execute investment analysis and activities to increase engagement and promote good governance.

ESG progress

As a DFM, we outsource the majority of our investment decision-making to asset managers and we therefore scrutinise managers' ESG practices via our manager due diligence process and ongoing report backs. The integration of ESG has always been an important component of our investment due diligence, allowing us to evaluate how managers consider the different components into security selection. Between 2020 and 2022, we conducted several surveys – see below – to help standardise ESG qualitative information and provide the industry with trends regards ESG integration and sustainability.

Looking back... timelines

Since inception	2017	2020	2021	2022	2023
ESG integration was predominately through manager due diligence meetings.	ESG policy formulated and approved.	Asset Mnager *Industry Survey*: Integration of ESG in managers' investment processes.	Gender diversity survey focusing on contributors to investment decision making. Asset Manager Industry Survey: Managers sustainable business practices	Asset Manager Industry Survey: Integration of ESG in managers' investment processes – highlighting improvements from 2020 survey.	Development of the 4-Pillar ESG framework and scoreboard.

MANAGER INSIGHTS

Championing change: ESG scorecards [cont.]

The outcome of these surveys, together with all the global standards, resulted in us establishing a comprehensive 4-pillar ESG evaluation framework (see diagram below) and associated score card.

Pillar 1 (15%): Sustainable Business Practices.

We evaluate managers as responsible citizens by assessing the consideration of their own ESG practices and footprints as asset managers. Guided by the SDGs, we endeavour to understand the incorporation of sustainability into managers' business strategies and their various CSI initiatives.

Pillar 2 (30%): Transformation.

We fundamentally believe that diversity builds stronger teams and contributes to business sustainability and that diversity within investment teams contribute to better decision-making.

Pillar 3 (40%): Investment decision-making.

The consideration of ESG risks and opportunities is paramount to investment decision making. As a result, the integration of ESG into the investment process has the highest weighting in the overall scorecard.

Pillar 4 (15%): Stewardship.

As stewards of our investors' capital, managers have a responsibility to create long-term shareholder value by holding companies accountable through their company engagements, including proxy voting.

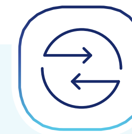
HOLISTIC SCORECARD

Sustainable business practices

15%

Transformation

30%



Integration of ESG into investment process

40%

Stewardship

15%

MANAGER INSIGHTS

Championing change: ESG scorecards [cont.]

As with most investment related topics, investing with an ESG lens is multi-faceted and complex. Our overall assessment of the underlying pillars is predominantly qualitative, whereby we assess the robustness of the policies of our managers that govern/oversees their activities and the degree to which policies are put into practice.

Manager scorecard

To date, we have evaluated roughly half the managers on our target list. The table below provides an evaluation of the underlying managers included in our DFM solutions.

Criteria	Weights	Total Manager Score	Large* Manager Score	Boutique** Manager Score
Pillar 1	15%			
Evaluation of the required policies that are in place	10%	4.7	4.9	4.7
Incorporation of SDGs in business practice	5%	3.9	4.2	3.8
Pillar 2	30%			
Evaluation of transformation policy and targets	10%	3.7	3.9	3.6
Transformation metrics	20%	2.9	2.9	2.8
Pillar 3	40%			
Evaluation of ESG Policies (or components of the RI policy), endorsements or signatories	10%	4.5	4.9	4.2
Assessment of ESG integration and putting policies into practice	30%	3.9	4.4	3.5
Pillar 4	15%			
Evaluation of components of RI policies that covers proxy voting, engagements, and exclusions	10%	4.2	4.6	3.8
Assessment of stewardship in practice	5%	3.7	4.6	3.1
Final – average ESG score	100%	3.8	4.2	3.6

* A large manager would have assets in excess of R100 billion and often has sub-teams (or franchises) responsible for specific mandates. Take note that there can be boutique managers with AUM more than R100 billion.
** A boutique manager typically has less than R100 billion in AUM, with a smaller team that is generally responsible for all mandates. The origin of the asset manager can also influence whether they are classified as boutique.

MANAGER INSIGHTS

Championing change: ESG scorecards [cont.]

We score each component out of 5 and on average, our managers have achieved a fair score driven by the following factors:

- Strong corporate governance policies to manage conflicts of interest and ensure ethical business practices.
- A strong sense of social responsibility engaging in various CSI initiatives to address the myriad of societal ills with a focus on poverty alleviation, education and skills development.
- ESG focus remains heavily weighted to the governance factor. Given global concerns around climate change, environmental factors are the second largest focus area, especially for resource companies. Some managers have started measuring the carbon footprint of their portfolios relative to a benchmark index.
- Many managers also incorporate ESG data from external data providers. However, it is important to note that there are several pitfalls to using ESG data, such as the inconsistency and a lack of reliable and accurate data. This requires managers to critically evaluate the use of external data.
- Given the strong emphasis on governance amongst our asset managers it is not surprising that the engagement of our managers with companies is quite good.
- Amongst the larger asset managers, detailed stewardship reports have become commonplace in recent years.

The gaps

Overall we have observed a positive trajectory in terms of the ESG integration and sustainability practices of our managers. However, we are of the view that there are several areas where managers can improve to entrench practices in a more sustainable way, including improving the diversity of their investment teams. These gaps include:

- Managers fall short in terms of measuring and monitoring their own environmental impact as a business.
- The lack of transformation and broad-based empowerment within investment teams remain a concern. Although we consider the B-BBEE ratings of managers, this is only a small component of our overall assessment. Our analysis focuses mainly on the diversity of the key contributors to investment decision making, such as the analysts, portfolio managers, the Heads of Investments and Chief Investment Officers, by looking at the actual composition of the investment team.
- We are cognisant that boutique asset managers have flatter team structures and less resources to attract talented individuals from a relatively narrow pool. Boutique managers have lamented the difficulty in growing talent as strong junior individuals are 'poached' by larger firms with bigger cheque books. Through our qualitative assessment we are able to recognise managers that contribute to the overall transformation of the industry.
- In terms of ESG integration, the social factor remains under-researched.
- The integration and focus of bigger asset managers seem to be more evolved. These managers have more resources in terms of balance sheets and people; and often have global reach where legislation such as the Sustainable Finance Disclosures Regulation (SFDR) in the European Union is a lot more prescriptive on ESG reporting requirements.

Important journey with asset managers

As a DFM we view our ESG approach as a journey and one that will continue to evolve to incorporate global best practice. Ultimately, we want to partner with managers that are committed to sustainable business practices, value having diversity in their teams and are responsible stewards of our investors' capital. We believe that our ESG framework, scorecard and continuous engagement with managers, will lead to a more sustainable investment industry for all.

Since we are committed to the principles of transparency and continuous improvement, the outcome of our evaluation and associated scoring is discussed with each manager and where necessary plans and targets are put in place to close out gaps from the overall scorecard assessment.

PRACTICE NOTES

Lump sum withdrawals at retirement – do not run into an unexpected tax bill

Albert Louw CFP®
Head: Content & Practice Management

Key Points:

- Although the tax-free lump sum amount has been increased to R550 000, the rules remain the same.
- Your total tax-free lump sum applies over your lifetime and will be less at retirement if you have made previous withdrawals.
- There is no perfect formula for taking a lump sum more than the tax-free amount of R550 000.

When you formally retire from your pension plan and/or retirement funds, you may only take (or commute) a lump sum equal to a maximum of one-third of the retirement interest in that fund.

The balance must be used to buy an annuity. This rule does not apply if the entire value of the fund is less than R247 500, in which case, you may take the full retirement interest as a lump sum.

If your total benefit is < R247 500, you can withdraw the full amount

Tax-free lump sum amount increased

Tax free lump sum increased by R50 000

As announced in this year's budget speech, the tax tables for lump sum withdrawals from retirement funds have been amended for the 2023/2024 tax year (see appendix that follows).

A notable change is that the tax-free withdrawal amount has increased from R500 000 to R550 000.

On eventual retirement – do not forget previous withdrawal(s) – if any

When it comes to the tax-free lump sum withdrawals, it is important to remember that tax is applied as an aggregate across all retirement funds and not per withdrawal.

Previous withdrawals reduce your tax-free amount

This means that if you have made previous cash withdrawals – including those made in respect of severance benefits – tax will be calculated on the cumulative amounts.

Thus, any previous withdrawals need to be considered when opting to take a lump sum at retirement. Previous withdrawals may result in you not having a tax-free amount available at retirement.

Example 1: Lump sum withdrawal less than R550 000

Mr. Mokoena retired from his retirement annuity (RA) when he turned 55 – before 1 March 2023 – and took a cash lump sum of R500 000, receiving the full amount tax-free.

After 1 March 2023, Mr. Mokoena, now 60 years of age, is retiring from his pension fund and would like to take a cash lump sum of R100 000.

R50 000 of the R100 000 lump sum taken will be tax-free and R50 000 will be taxable. Looking at **Table 1**, this is because the total value of Mr. Mokoena's previous retirement lump sum (R500 000) taken before 1 March 2023, was less than R550 000. He thus has R50 000 remaining that is tax-free. The tax on the R100 000 he is opting to take now would be calculated as follows:

PRACTICE NOTES

Excess retirement contributions - what is allowed for income tax deduction (cont.)

Table 1

Step 1	
Calculate the tax on the total lump sums (previous and current) by applying the retirement lump sum tax table – at retirement – from 1 March 2023.	• Total lump sums (current and previous) = R500 000 + R100 000 = R600 000 • Tax on total lump sums (current and previous) = (R600 000 – R550 000) x 18% = R9 000
Step 2	
Calculate the tax on the previous lump sum • by applying the retirement lump sum tax table at retirement – from 1 March 2023. This step is important and tricky to understand, as it applies the hypothetical tax that Mr. Mokoena would have paid on the previous taxable lump sum using the current tax table, and not the actual tax that Mr. Mokoena paid using the tax table prevailing when the previous lump sum was received five years ago.	Tax on previous lump sum (R500 000) = R0 (the amount falls within the R550 000 tax-free portion).
Step 3	
Calculate the tax on the current lump sum • taken – after 1 March 2023.	Tax on current lump sum taken (R100 000) = tax on total lump sums less tax that would have been paid on previous lump sum (using the current tax table) = R9 000 – R0 = R9 000

Mr Mokoena will therefore pay tax of R9 000 on the R100 000 retirement lump sum. He will receive R50 000 of the lump sum tax-free, as he had not fully utilised his new R550 000 lifetime tax-free allowance.

PRACTICE NOTES

Excess retirement contributions - what is allowed for income tax deduction (cont.)

Example 2: lump sum withdrawal more than R550 000

In this example Mr. Mokoena's prior taxable lump sum was R700 000. He has already fully utilised his tax-free lifetime amount of R550 000, as his initial taxable lump sum exceeded the current tax-free amount. The tax on the second retirement lump sum of R100 000 that he has opted to take after 1 March 2023, would be calculated as follows:

Step 1	
Calculate the tax on the total lump sums (previous and current) by applying the retirement lump sum tax table – at retirement – from 1 March 2023.	• Total lump sums = R700 000 + R100 000 = R800 000 Tax on total lump sums = R39 600 + (R800 000 – R770 000) x 27% = R47 700
Step 2	
Calculate the tax on the previous lump sum by applying the retirement lump sum tax table at retirement – from 1 March 2023.	Tax on previous lump sum (R700 000) = (R700 000 – R550 000) x 18% = R27 000
Step 3	
Calculate the tax on the current lump sum – after 1 March 2023.	Tax on current lump sum (R100 000) = tax on total lump sums less tax that would have been paid on previous lump sum (using the current tax table) = R47 700 – R27 000 = R20 700

Mr. Mokoena will therefore pay tax of R20 700 on the R100 000 retirement lump sum, as he has already fully utilised his R550 000 lifetime tax-free amount and the R100 000 is therefore, fully taxable.

Taking a lump sum greater than your R550 000 tax fee amount

It is important that cash commutations at retirement are carefully considered as part of your broader financial plan. The one-third cash lump sum clearly gives you better control over your money, allowing you the flexibility to invest it when and how you see fit. You are not permitted to make lump sum withdrawals from a life annuity or living annuity, so it is important to carefully consider whether you may need access to lump sum capital when you reach retirement.

The composition of your overall investments – the split between compulsory and discretionary money – is a significant factor in determining the lump sum amount taken at retirement.

Compulsory vs. discretionary conundrum

If, for example, you have very little discretionary savings, you may be 'forced' to take your full one-third commutation for cash flow needs later in retirement and for access to emergency capital. Hopefully you are debt free at retirement and do not have to use a portion of your commutation to repay any outstanding debt.

Access to a cash lump sum is great, but only if the plan is to invest the money wisely and not spend it. Hence, it is important for investors to be smart and have a clear plan. There are several aspects to consider:

Inheritance – if your financial plan proposes that a life annuity will be optimal, remember that there will be no capital payout to your heirs. In this case, you may want to take the maximum lump sum, as the money can then be used to make an investment to create an income, together with any residual capital, which passes to your heirs on your death.

PRACTICE NOTES

Excess retirement contributions - what is allowed for income tax deduction (cont.)

Estate liquidity – when considering whether to make a cash commutation, be sure to calculate the liquidity in your estate, bearing in mind that if any shortfalls exist, you may want to set aside some of your cash lump sum for these purposes and invest accordingly.

Income tax – on the assumption that you also have discretionary investments at retirement. The possibility exists for you to lower your living annuity drawdown rate because you also have discretionary savings (plus your one -third cash lump sum) invested to complement your overall income needs in retirement. Income from a compulsory living annuity is taxed at your marginal tax rate – say for example at 30%. Not only will your income tax now be lower because of the lower drawdown rate but also because your discretionary portfolio is taxed at a lower rate than your marginal tax rate of 30%. Why? Because you pay zero tax on withdrawals from your TFSA (which is why it is so important to save in a tax-free vehicle), and dividend tax and CGT are only at 20% and 12% (40% x 30%) respectively.

Lastly, on your money market assets you are allowed the initial exemption of R23 800 (≤ 65) and 34 500 (≥ 65) after which your interest will be fully taxable at at your marginal income tax rate.

Appendix: retirement withdrawal tax tables applicable 1 March 2023

TAXABLE INCOME	RATE OF TAX
R1 – R550 000	0% OF TAXABLE INCOME
R550 001 – R770 000	18% OF TAXABLE INCOME ABOVE 550 000
R770 001 – R1 155 000	39 600 + 27% OF TAXABLE INCOME ABOVE 770 000
R1 155 001 AND ABOVE	143 550 + 36% OF TAXABLE INCOME ABOVE 1 155 000

Conclusion

It is important to fully understand the tax consequences of your decision to withdraw a lump sum from your retirement fund before the instruction is submitted to the retirement fund administrator. Key to this is understanding how amounts you may have received in the past – such as a resignation benefit from a previous employer – will impact the tax liability on your planned cash withdrawal. Thus, your tax-fee amount may be less than the 'once-in-a- lifetime' R550 000 and your tax obligation higher than anticipated – do not be surprised.

INN8 Invest is not a tax professional. Please seek the appropriate assistanceladvice from a qualified financial or tax adviser.

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