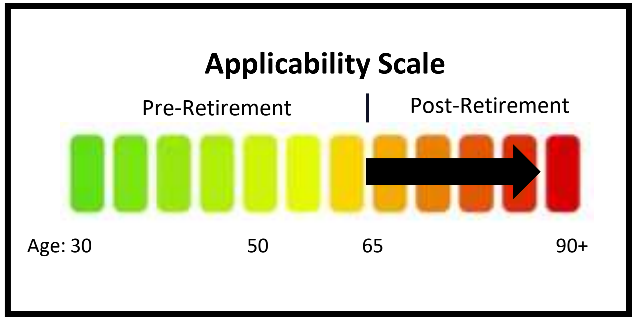


# GAP MAYNARD

Personalized Investment Advice

**TOPIC: South African – Living & Life Annuities**

# Basic Living & Life Annuity Information

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**Definition**

- A Living or Life Annuity is a financial product that pays the owner a regular (annuity) income in retirement. Living and Life annuities are usually utilized when people retire and no longer have a formal income in the form of a salary. The annuity essentially pays them a monthly income.
- Living and Life Annuities are applicable for individual's who have reached retirement age or older

**Basic Facts**

- A living or life annuity is a product that the owner purchases from a service provider. The product is bought with proceeds from a Retirement Annuity, Preservation Fund (Pension & Provident), Pension or Provident fund or cash.

**Life Annuities:**

- A Life Annuity (also called a Guaranteed annuity) pays you a fixed monthly income for the rest of your life. The amount you receive depends of how much you contribute. This income usually increases with inflation each year. However when you pass away, the annuity income dies with you, and is not left to any beneficiaries. Life or guaranteed annuities are often utilized for smaller sums of money (values up to R1m).
- A Life Annuity is fairly simple in that you buy the product once and don't have to think about it again, however if you pass away shortly after taking out a Life Annuity, you could lose the entire pot to the product providers. Most providers today do state a minimum period they are prepared to pay the annuity income out for, even if the policy owner dies before (usually around 10 years from when the policy is originally taken out). Hence why Life Annuities are often utilized for smaller investment amounts.

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**Living Annuities**

- A Living Annuity is a pot of money that, in addition to providing you an annuity, allows the policy holder the ability to invest the funds in the pot. Additionally, when you pass away the annuity income (what's left in your pot) can be left to your nominated beneficiaries.
- Living Annuities, unlike Retirement Annuities and other pre-retirement pension saving vehicles, is not restricted to **Regulation 28**, and therefore has a much wider pool from which to select investment opportunities.

- Once a year you are allowed to decide how much income you wish to **drawdown** on a monthly, quarterly, 6-monthly (semi-annually) or annual basis from your LA. The minimum withdrawal you MUST drawdown when taking out a Living Annuity is 2.5% of the value of the Living Annuity per annum.

  *Example: If you had a LA worth R10m and decided to withdraw 2.5% you'd get R250,000 (2.5% of R10m = R250k) a year or R20,833.00 a month (R250k divided by 12 months) before tax.*

- The maximum, a person can withdraw from his or her LA is 17,5% per annum. Using the same scenario as above, this would mean the following:

  *Example: If you had a LA worth R10m and decided to withdraw 17.5% you'd get R1,750,000 (17.5% of R10m = R1.75m) a year or R145,833.00 a month (R1.75m divided by 12 months) before tax.*

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**Living Annuities Continued:**

- It is very important to understand that you can only ever drawdown a maximum of 17,5% per annum on the LA value. Therefore if you had R10m it would NOT take just under 6 years (R10m divided by R1,75m = 5,7yrs) for you to completely deplete the fund value, rather a great deal longer. Rather you'd receive R1,75m in year 1 and in year 2 and assuming the funds left in the LA did not grow at all, the new fund value would be R8,25m (R10m minus R1,75m = R8,25m). Therefore in year 2 you could get access to 17,5% of R8,25m or R1,443,750 (17.5% of R8,25m) a year or R120,312.50 a month before tax.
- From the above you can see how important it is to ensure the amount you withdraw and the amount the funds grow are optimized so as to ensure your LA lasts as long as possible.

**<u>Definitions</u>**

- **Regulation 28 –** This regulation is part of the Pension Fund Act and aims to ensure that individuals' hard-earned savings are invested in a sensible way and protected from poorly diversified portfolios. Regulation 28 limits a money managers' allocation of retirement savings to certain asset classes including equities, property and foreign assets (max of 30%).  The overall objective is to protect consumers by restricting the allocation of investor funds to riskier assets on the one hand, but on the other hand to allow for the selection of more strategic and complex options.
- **Drawdown –** This is a term used to explain how much money an individual withdraws from their annuity on a monthly, quarterly, 6-monthly or annual basis.

# Basic Living & Life Annuity Information

**Living Annuities and Tax**

- Although there is a tax exemption on annuity income, you do have to pay tax at your marginal income tax rate on sums above the exemptions.
- The latest exemption rates as stipulated by SARS for the 1 March 2020 to 28 February 2021 year of assessment for the tax season starting during 2021 are: **
    - Person below 65 – R83 100 per annum
    - Person 65 and above but not yet 75 – R128 650
    - Person 75 and above – R143 850.
- This means a person aged 68 who has an annuity income equal to or less than R128,650 a year will pay no tax. If the same person's annuity income is greater than R128,650 a year, then they will pay tax on the amount above R128,650 at their marginal income tax rate.
- On your death, the funds can be transferred directly to your beneficiaries without your estate attracting estate duty or executor's fees. It is important to nominate beneficiaries otherwise the LA will form part of your estate and therefore be subject to estate duties.
- You beneficiaries have access to the funds within a Living Annuity almost immediately and can choose what they wish to do with it.
    1. Keep receiving the annuity income like before
    2. Withdraw the funds in total – however they pay tax on this
    3. Partially withdraw and receive reduced annuity income – still incurs tax

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The Pros and Cons associated with Living and Life Annuities care summarized below.

## LIVING ANNUITIES

**PROS**

- Access to a wide range of investment opportunities
- Some tax relief on annuity income according to your age.
- Can be left to beneficiaries
- Reduce your estate duty if left to beneficiaries
- Provide regular income
- Ability to change withdrawal rates on an annual basis.

**CONS**

- Never have full access to capital
- Limited to a maximum of 17,5% of the fund value

## LIFE ANNUITIES

**PROS**

- Simple concept to grasp
- Guaranteed income for life
- Some tax relief on annuity income according to your age.
- Good for smaller fund value sizes.
- Do not form part of your estate on death.

**CONS**

- Cannot pass on to your beneficiaries
- No investment exposure
- Funds die with you
- Cannot amend or alter annuity income amount

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