Vickers & Peters

LIFESTYLE AND ASSET PLANNING

"Around the Table with Vickers & Peters Financial Planning"

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Changes to the Taxation of Retirement Benefits

The Minister of Finance tabled the Taxation Laws Amendment Bill on 1 September 2009 and this culminated in the promulgation of the Taxation Laws Amendment Act No. 17 of 2009 (the Act) on 30 September 2009. The purpose of the Act is to effect certain amendments to the Income Tax Act and the following amendments are of relevance to the Pre and Post Retirement Planning environment.

Pre-retirement: Taxation of Withdrawal Benefits

Pre-retirement withdrawals, e.g. cash resignation benefit from former employer, withdrawals from a preservation fund and emigration withdrawals, are taxed differently to withdrawals at retirement (Post Retirement). The Act has legislated a new stand-alone table to tax withdrawal benefits (see **Table 1** below) which will apply retrospectively from 1 March 2009. The R22 500 exemption (this amount had recently been increased from R1800) has now been included in the table. Thus, from 1 March 2009 the first R22 500 of a withdrawal benefit is taxed at zero per cent (0%) and the balance is taxed in terms of the table below.

Lump sum benefits, i.e. pre retirement withdrawal of retirement benefits, are taxed on a ***cumulative basis***, which means all lump sum benefits received after 1 March 2009 will be taken into account when determining the tax payable on a specific lump sum benefit.

The following example is used in the Explanatory Memorandum on the Taxation Laws Amendment Bill, 2009 (hereinafter referred to as "the Explanatory Memorandum"):

Facts: Colin is a member of two pension funds when he resigns. Colin initially receives a R250 000 pre-retirement lump sum from the first fund. Colin subsequently receives another R350 000 pre-retirement lump sum from the second fund.

Result: In respect of the first fund lump sum, the first R22 500 is taxed at rate of zero per cent, and the remaining R227 500 is taxable at rate of 18 per cent. The result is tax payable of R40 950. In respect of the second R350 000 lump sum, this amount is effectively taxed at a rate of 18 per cent, resulting in tax payable of R63 000.

Post Retirement: Taxation of Retirement Benefits

When a member retires from a pension fund, pension preservation fund or a retirement annuity fund, he/she is only entitled to a maximum of 1/3 of the retirement interest as a lump sum and the balance must purchase an annuity. In the case of a provident and provident preservation fund, at retirement the client is entitled to the full benefit as a lump sum benefit.

The first R300 000 of the lump sum benefit is taxed at zero percent (0%) and the balance will be taxed in terms of a stand-alone table (see **Table 2** below). ***Please note in terms of the Act, amounts taken pre-retirement and after 1 March 2009 will reduce the R300 000 tax-free amount available at retirement***. Thus if a client had withdrawn R300 000 from his preservation fund prior to retirement, he/she will have no tax-free amount available, as it will have been reduced by the amount taken pre-retirement. This is referred to as the ***cumulative nature of lump sums***.

The following example is used in the Explanatory Memorandum:

Facts: Colin is a member of two pension funds when he resigns. Colin initially receives a R250 000 pre-retirement lump sum from the first fund. Colin subsequently receives another R350 000 pre-retirement lump sum from the second fund. Colin receives an additional R100 000 lump sum on retirement.

Result: The R100 000 is effectively taxed at a rate of 27 per cent after taking into account the prior pre-retirement lump sums, resulting in tax payable of R27 000.

Table 1: Pre Retirement

Taxable amount	Rate of tax
Not exceeding R22 500	0%
R22 500 < R600 000	18%
R600 000 < R900 000	R103 950 plus 27% of amount exceeding R600 000
Exceeding R900 000	R184 950 plus 36% of amount exceeding R900 000

Table 2: Post Retirement

Taxable amount	Rate of tax
Not exceeding R300 000	0%
R300 000 < R600 000	18%
R600 000 < R900 000	R54000 plus 27% of amount exceeding R600 000
Exceeding R900 000	R135 000 plus 36% of amount exceeding R900 000

Retrenchment Benefits

The amendment to retrenchment benefits provide that benefits payable by a retirement fund as a result of the retrenchment of a member of the fund are to be taxed in the same manner as a retirement benefit. This amendment is effective from 1 March 2009 and does not apply to a member who was a director of the company or at any time owned more than five per cent (5%) of the shares in the company.

VPFP Launch Offshore Funds

With an aim to improve the manner in which our client's offshore portfolios are managed and advised on, we are delighted to report the recent launch of two VPFP offshore funds.

One defining factor in the structure of our offshore funds is the exclusion of traditional Mutual Funds (Unit Trusts) in favour of Exchange Traded Funds (ETF's).

In this article I will provide a brief summary on the reasons for VPFP electing to use ETF's for our offshore portfolio management and any further detailed fund information can be obtained by contacting your Financial Advisor or dropping us an e-mail on clientservicing@vpfp.co.za

What is an Exchange Traded Fund (ETF)?

An ETF is a pooled investment vehicle that is traded on a stock exchange, similar to a stock, and holds assets such as stocks or bonds, and trades at the same price as the Net Asset Value of the underlying assets. An ETF differs from a normal Mutual Fund in the sense that an investor can trade an ETF in the secondary market at any time during the exchange's trading hours. Normal Mutual Fund investors will have to wait until the Net Asset Value (NAV) of the fund they want to buy is published before being able to buy units.

Most ETF's track an index and are managed to accurately mirror the performance of an index, aiming to provide investors with the same return as the underlying market. VPFP have used a combination of ETF's in all three portfolios for its underlying equity and fixed interest exposure.

ETF's have been chosen in the international structures for use in strategic asset allocation positions where active management has failed to outperform in the past. ETF's provide a simple way to implement a professional style approach to portfolio management and we believe this approach can trump securities only or Mutual Funds portfolio management strategies for the following reasons:

Better Diversification

Typically, the average investor portfolio tends to have a poorly diversified portfolio. There is often a concentration in sectors or types of stocks with very similar risk characteristics. Using an ETF to buy a core position provides instant diversification and reduces overall portfolio risk.

Improved Performance

It is widely accepted that a large portion (more than 50%, by most accounts) of professional international money managers underperform the stock market. The average individual investor typically fares worse. A portfolio that replaces some individual manager stock picking exposure with broad-based ETF's may be able to improve the overall performance of the portfolio.

Easier Rebalancing

A change in an investor's asset mix is easier to implement when using ETF's. If an investor wants to increase his or her equity exposure, the purchase of additional shares of an ETF makes it easy to do without having to buy additional single stocks or units, in the case of Unit Trust Funds, for existing holdings.

Easier to Monitor and Understand

The more stocks in a portfolio, the harder it is to monitor and manage; after all, there are more investment decisions that have to be made and more factors to be considered. With an ETF, the number of stocks can be decreased, resulting in a portfolio that is less complex and easier to understand.

More Tax Efficient

A portfolio containing Mutual Funds or single stocks tends to generate more trading activity as the market and investment outlook changes. With more trading activity, more capital gains will be realized and more taxes paid. ETF's are very tax efficient with capital gains only being triggered when the investor elects to disinvest from the investment product.

Lower Transaction Costs

With fewer trades there are fewer transaction costs. The small annual management fee ETFs carry is easily recovered from the savings on transaction costs. Depending on the client's existing Mutual Fund portfolio composition the reduction of fees can be dramatic.

A Decrease in Volatility

For the typical investor with an ETF holding, the overall portfolio will likely be less volatile than one made up entirely of stocks or equity based Mutual Funds.

Allows For Better Focus

In any well designed and diversified portfolio, an investor will have to invest in sectors or stocks that he or she does not like, but is required to own for diversification purposes. Using ETF's as a core position provides the necessary diversification, allowing the investment advisors (VPFP) to focus on preferred sectors or geographical locations for tactical allocation purposes.

Conclusion

With the introduction of ETFs the investment mandate of both VPFP offshore funds becomes practical to implement. It will not only make investment management easier, but the underlying portfolio will also be better diversified and future performance will likely improve.

Market Update - Market commentary from Celtis Capital.

International markets continued their upward trend during December, with the MSCI AC World (Net TR) Index rising 4.03%, led by developed markets which rose 4.12%. Emerging markets increased by 3.47%.

US non-farm payrolls declined by less than expected, confirming that the labour market is stabilising, unemployment however remains close to its record high. US Chicago PMI also rose to its highest level since August 2008. Emerging markets continue to see considerable growth in GDP compared with their developed counterparts, with India posting an increase in Q3 GDP of 7.9%.

The JSE returned a positive 2.87% led by a 4.15% increase in Industrials while Financials and Resources returned a positive 2.66% and 2.54% respectively. The All Bond Index gained 1.2%. The Rand strengthened a further 0.94% over the month.

Local economic data was mixed. CPI remained within the target band, rising by 5.8%, while the decline in PPI began to slow (negative 1.2% for November 2009). The Kagiso PMI Index rose above the key 50 index level for the first time since April 2008 indicating an economic recovery looking forward, however current economic indicators remain weak (Q3 formal employment declined by 3.9% y/y and retail sales continued their downward trend, declining by 6.5%).

We continue to look to increase international exposure and are monitoring fixed interest prices carefully to potentially increase exposure here as well.

It must be noted that a performance report over a small investment period can produce large fluctuations in prices which can be misleading or misinterpreted for future return expectations. Due to the VPFP Funds containing other assets classes such as bonds, cash, property and offshore assets, the JSE Allshare being an equity only index, is not an appropriate benchmark for an accurate assessment of the VPFP Funds performance.

Of far more importance to us is client long term wealth creation and the achievement of our target return objectives of CPI +2%, CPI +4% and CPI +6% over a rolling 3-5 year period.

For further information on the VPFP Funds please send us an e-mail or visit our website www.vpfp.co.za **where you can access our latest information and download the VPFP Fund fact sheets.**

VPFP would like to wish all our clients a healthy and prosperous 2010.

At your service…

Financial Planning

James Vickers
Direct: +27 11 803 8105
E-mail: mailto:jvickers@vpfp.co.za

Ian Peters
Direct: +27 11 803 8158
E-mail: mailto:ipeters@vpfp.co.za

Graeme Holt
Direct: +27 11 803 7642
E-mail: mailto:gholt@vpfp.co.za

Jacqui Nolan
Direct: +27 11 803 7782
E-mail: mailto:jnolan@vpfp.co.za

Marinda Combrink
Direct: +27 11 803 7399
E-mail: mailto:mcombrink@vpfp.co.za

Tracy Tan
Direct: +27 11 803 7393
E-mail: mailto:ttan@vpfp.co.za

Yolandi Volschenk
Direct: +27 11 803 7689
E-mail: mailto:yvolschenk@vpfp.co.za

Andylee Scott
Direct: +27 11 803 6519
E-mail: mailto:ascott@vpfp.co.za

Employee Benefits

Chris Ellis
Direct: +27 11 803 3663
E-mail: mailto:cellis@vpfp.co.za

Guy Peters
Direct: +27 11 803 7379
E-mail: mailto:gpeters@vpfp.co.za

Andre Bester
Direct: +27 11 803 7379
E-mail: mailto:abester@vpfp.co.za

CELTIS CAPITAL

Tom Barlow
Direct: +27 11 803 6597
E-mail: mailto:tom@celtiscapital.co.za

Tarryn Cameron
Direct: +27 11 803 6597
E-mail: mailto:tarryn@celtiscapital.co.za

Our services include…

- Pre and Post Retirement Planning
- Local and Global Investments
- Business Assurance – Keyman and Partnership
- Personal and Group Life Assurance
- Employee Benefit Advice and Products
- Tax and Estate Planning

Vickers & Peters

LIFESTYLE AND ASSET PLANNING

FINANCIAL PLANNING

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EMPLOYEE BENEFITS

FIDUCIARY SERVICES

ADMINISTRATION SERVICES

Contact us

Physical address: Vickers & Peters Financial Planning Pty (Ltd), Unit 13 & 14, Rivonia Gate, 381 Rivonia Boulevard, Rivonia.
Postal Address: PO Box 926, Rivonia, 2128
e-mail: clientservicing@vpfp.co.za
Website: http://www.vpfp.co.za

If you would like to be removed from our mailing list we would appreciate it if you would stipulate REMOVE in the subject line of a blank e-mail message.

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