Vickers & Peters

LIFESTYLE AND ASSET PLANNING

"Around the Table with Vickers & Peters Financial Planning"

Issue 21 – Jan 2012 **Quarterly Publication** *Compiled by Graeme Holt*

Why Retirement Annuities make sense

February heralds the end the tax year and with it your last opportunity to claim a tax deduction on your annual retirement contributions. Despite the introduction of Regulation 28 (which sets restrictions on exposure to certain asset classes), and some negative press, Retirement Annuities (RA) carry a host of benefits and can still form an integral part of your retirement portfolio, here is why:

Tax benefits

The greater of the following contributions to retirement annuities can be tax deductible per tax year:

• 15% of your non retirement funding income OR
• R 3 500 less pension fund contributions OR
• R 1 750

For example: Joe is earning R300 000 per annum. He is thus able to deduct R 300 000 X 15% = R 45 000 pa (R 3 750 pm) as he is not on a pension or provident fund. He is currently in the 30% marginal tax bracket so theoretically he could save R 13 500 per annum in tax (30% X R 45 000).

In addition to the tax deduction on contributions, investment returns in retirement funds are currently taxed at 0%. This means all rental income, interest received and capital gains tax is non-taxable. To illustrate the full impact of these tax concessions on long term investment capital consider the following example:

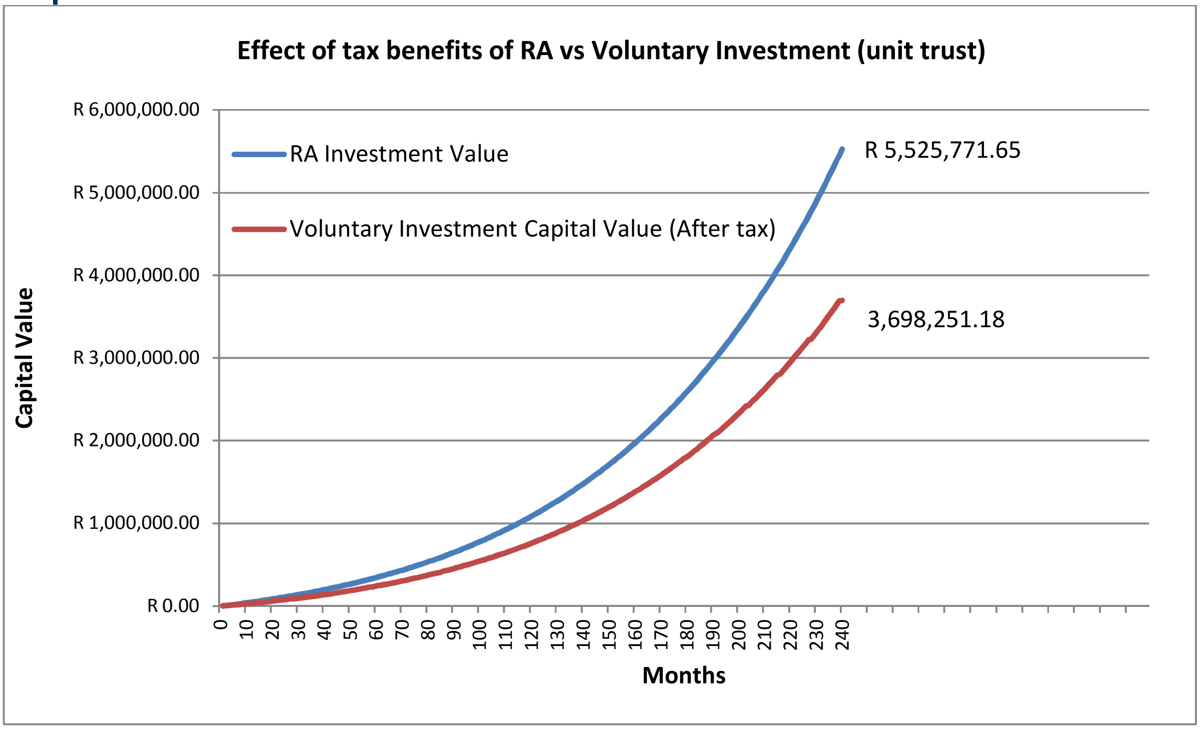
Joe would like to retire in 20 years time. After conducting a Financial Needs Analysis (FNA) it was established that for Joe to retire with a monthly income of R10 000.00 (Present Value), R32 071.00 (Future Value), Joe will need a capital amount of approximately R5 000 000.00 when he retires. Joe has the option to invest in one of two investment products. The first product is a Retirement Annuity and the second is a voluntary purchased unit trust product.

Assumptions:

	Retirement Annuity**	Unit Trust (after tax investable asset)
Investment term	20 Years	20 Years
Monthly contributions (starting)	R3 750.00	R2 625.00*
Annual escalation rate of contributions (inflation @ 6%)	6%	6%
Annual investment return	12%	12%
Marginal Tax Rate	30%	30%
% of assets invested in fixed interest (balance in equity)	50%	50%

*After tax contributions
**Retirement fund tax 0%

Graph1



Source: Vickers & Peters Financial Planning

As can be seen in **Graph 1** above, after 20 years, the capital value of the RA is significantly higher than the value of the voluntary unit trust investment. The compound growth on the additional savings afforded to the RA, thanks to the tax benefits, can mean the difference between Joe being able to retire or needing to continue to work.

- This example was based on a 30% marginal rate throughout. In practice Joe's tax rate should increase to 40% over the coming years. Thus making the RA even more attractive due to the increase in future savings.

- Joe can get the immediate tax deduction from the RA and save the extra R 13 500 per annum in a more aggressive unit trust investment or share portfolio (voluntary assets) therefore increasing his returns over the long term and increasing his liquidity.

- In the event Joe becomes bankrupt, the proceeds of the RA are protected from creditors.

- Joe would be able to nominate a beneficiary on a RA which he could not do in a unit trust, thus reducing executor's fees should he pass away.

- An RA ensures that Joe's savings are kept for retirement. It is important not to underestimate the temptation to withdraw from a voluntary savings account.

To enjoy the above mentioned benefits Joe will have the following restrictions imposed on him as an RA investor.

- Regulation 28 – Joe will have restrictions on his exposure to certain asset classes.

- Liquidity – Joe will only be allowed access to the money on retirement (age 55) or disability or on formal emigration.

- At retirement Joe will be allowed to take up to one third in cash with the remaining two thirds used to purchase a compulsory annuity (pension).

Product choice

For those investors looking to boost their retirement savings an investment RA is a good choice. Although you cannot access the money before age 55 (which could be seen as a good thing), an investment RA allows the investor greater flexibility and choice. There are no contractual terms, as it is in most cases with your traditional life product RA, which means there are no penalties if you decide to stop contributing. In addition you can make ad hoc contributions when you like or reinstate your regular contributions at the same, higher or lower rate. There are also no maturity dates beyond the legislative retirement age 55, which means you are not locked in for extended periods or penalized for early exit. In terms of fund manager selection your investment choice is unrestricted, with Regulation 28 restricting exposure to certain asset classes.

Conclusion

Depending on your circumstances, an RA can be a valuable asset in your retirement portfolio. If used correctly, an RA can provide the difference you might need to help you achieve your retirement goals.

If you would like further information on the suitability of an RA for your retirement plan or if you would like to make a contribution to your RA before the tax year end (29 Feb 2012) and need help determining what would be the most tax efficient amount, please contact a VPFP financial advisor.

10 Good reasons for a buy and sell agreement to be funded by life insurance

In the next few issues of this newsletter we will be looking closely at issues relating to buy and sell agreements funded by life insurance. In this first edition, we focus on 10 good reasons why business owners should enter into a buy and sell agreement.

What is a buy and sell agreement?

To recap, we again, by way of an example, look at what a buy and sell agreement is*. For the purpose of this series, the words "partner" and shareholder" will also be appropriate, depending on the entity involved.

John and Jack are equal co-shareholders in Hats R Us (Pty) Ltd.

In this context a buy and sell agreement is an agreement (or obligation) between John and Jack, obligating them to sell on their deaths (or disability) their interest to the survivor and likewise to purchase the deceased (or disabled) shareholder's interest. The agreement is reciprocal in that they also agree that the survivor will buy the deceased (or disabled) co-shareholder's interest.

The above agreement was funded by life insurance policies which each co-shareholder takes out on each other's lives.

Why should John and Jack enter into a buy and sell agreement funded by life insurance?

- **Certainty** – John and Jack are certain that their respective shares are to be purchased by the remaining co-shareholder in the event of their death or disability. The very purpose of estate planning is to provide parties with certainty regarding their business interests.

- **Protection of business value for the family** – The agreement ensures certainty to the family of the deceased or disabled shareholder of future income, by providing the family with the proceeds of the policy, equal to the market value of the co-shareholder's interest in the business, after the death or earlier disablement of a co-shareholder.

- **Protection of minor beneficiaries** – In the event that John or Jack wants to benefit minor beneficiaries, the proceeds of the policy, after payment to the deceased estate, can be placed in trust. The funds will then be administered by the Trustees of the trust for the sole benefit of the minor beneficiaries.

- **Estate duty concessions** – provided that the agreement is structured correctly, the proceeds of the policy will be estate duty free in terms of Section 3 (3)(a)(iA) of the Estate Duty Act**.

- **Capital Gains Tax concession** – the proceeds of the policy will not attract capital gains tax provided that the policy was affected for the purpose of acquiring:

    - The co-shareholder's interest in the partnership concerned or;
    - The co-shareholder's share or interest and no premium was paid or borne by that shareholder while the other co-shareholder was the beneficial owner of the policy.

- **Agreed price** - the purchase price of a co-shareholder's interest in the business is agreed upon and certain.

- **Valuation method** - the method of determining the purchase price of each co-shareholder's interest in the business is certain. Certainty is also obtained that the value of the business in terms of the agreement is updated annually, ensuring that the policy cover remains in line with the market value of the business.

- **Protection for the remaining owners –** there is no risk of outsiders joining the business who may be unskilled or incompatible and therefore ensuring that the business will continue with minimal disruptions.

- **Right amount at the right time** - life insurance is the most cost effective way of ensuring the right amount pays out when it is needed the most.

- **Disability cover** - disability cover provides for the disabled shareholder when the business can't afford to. New business owners need not worry about providing out of the business for the medical and life expenses of the disabled co-shareholder while running the business on their own.

In the next edition of "Around the Table" we will look at:

- Reasons why you should review your current buy and sell agreement on a regular basis.

Notes:
*Volume 30, Estate Planning Essentials dated 3 September 2010.
**Act 45 of 1955

The dangers of an unsigned Will

In previous issues of "Around the Table" (Jan 2011, Issue 17) we dealt with the importance of complying with all the formalities of drafting a Will in order to make a Will valid and binding.

A recent Supreme Court of Appeal ('SCA') case, Hendrik van der Merwe v The Master and the SPCA [2010] ZASCA 99, illustrates just how important these formalities are.

John van Schalkwyk and his lifelong friend, Hendrik van der Merwe, lived in different provinces, but maintained regular contact. In 2004 Van Schalkwyk signed a valid Will appointing the SPCA as the sole heir of his estate, but in 2007 the two friends discussed the future, and agreed that each would appoint the other as his sole heir. Accordingly, Van Schalkwyk sent Van der Merwe an e-mail containing a draft Will appointing him as sole heir, and then phoned him to check whether it met with his approval. In the same spirit, Van der Merwe signed a Will (prepared by his own attorney) appointing Van Schalkwyk as his sole heir. Van Schalkwyk retired early in 2008 and died a month later without having signed his draft Will, and the Master accepted his 2004 Will.

Van der Merwe then applied to the High Court to have the unsigned Will accepted as valid. The court ruled against him on the grounds that in the absence of a signature there was no proof that the e-mail was a valid Will, and that to accept it as such would open the floodgates to anyone who produced an unsigned document claiming it was a valid Will. Van der Merwe appealed to the SCA which examined all the circumstances, especially the fact that the deceased had no descendants or dependants, that the Will was still stored on the deceased's computer, that he had nominated Van der Merwe as his pension fund beneficiary, and that Van der Merwe had arranged for his own Will to be prepared after receiving Van Schalkwyk's e-mailed Will. The SCA held that section 2(3) of the Wills Act required the court to examine the testator's true intention, and that failure to comply with the formalities should not frustrate this intention. The court ordered the Master to accept the e-mailed unsigned Will.

If one compares the effort involved in complying with the formalities required by the Wills Act to the substantial cost and time involved in launching two court cases, it is clear that the taking of professional advice when finalising one's Will is by far the best course of action.

It is recommended to review your Will at least every three years or in the event of a change in the family i.e. the birth or death of an intended beneficiary or change in your asset composition or situation.

If you would like further information on drafting a new Will or if you have any questions relating to your existing Will please contact us on 011 803 7399 or clientservicing@vpfp.co.za

Vickers & Peters will gladly assist in reviewing and drafting your Will.

Market Update *– Q4 2011 - by Tarryn Cameron of Celtis Capital*

Macro Overview

The European Debt Crisis continues to plague market sentiment, even after agreement was finally reached on a Greek rescue package in October. Volatility returned to global equity markets set off by jumps in the cost of borrowing in the likes of France, Spain and Italy (the world's eighth largest economy and the Euro Zone's third largest). Spain, Italy and Belgium also saw their government debt downgraded.

The European Central Bank (ECB) cut interest rates twice over the quarter, effectively reversing the 50 bps hikes implemented during the year. While inflation remains above the ECB's target of 2%, the level of uncertainty has increased and substantial downside risks to economic activity remain.

In China, the People's Bank of China (PBOC's) measures to curb rising inflation has paid off as CPI has fallen to 4.20%. The PBOC set the target rate at 4% for 2011. Consequently, the PBOC cut the Reserve Requirement Ratio (RRR) for the first time in three years, on 5 December 2011, by 0.50%, bringing the RRR down to 21.00%.

Unemployment in the US (a critical element to growth in the world's largest economy) fell surprisingly in October to 8.60% from 9.00% mainly as a result of a decline in the labour market participation rate. Non-farm payrolls were also encouraging however, rising by 120,000. The labour numbers are reassuring and suggest that the US economy is likely to avoid slipping back into recession.

Performance – *what added and what detracted?*

Local and global equity markets contributed favourably to the funds' performance over the quarter, with international performance being further fueled by a slightly stronger rand/US$ exchange rate.

To a lesser extent, domestic fixed interest also added positively. International fixed interest, however, was the loser over the period, detracting from performance for the quarter, although being outweighed to some degree by a mildly stronger rand.

Local property was also a weak performer over the period, as was local cash.

Position going forward

Global volatility is still an overriding factor in present decision-making and for the time being we maintain our overweight position in offshore equities, whilst remaining neutral domestic equities and property and underweight fixed interest, both locally and internationally.

Going forward we maintain a close eye on the situation in Europe, watching carefully how it unfolds, and we remain cautious in our view. We will take action as is necessary, comfortable in our current positioning going into the New Year.

VPFP Fund Performance for the Period Ending 31 December 2011

	3 Month		6 Month		12 Month		24 Month		36 Month		Inception (12/5/2008)	
	Return	**Risk**	**Return**	**Risk**	**Return**	**Risk**	**Return**	**Risk**	**Return**	**Risk**	**Return**	**Risk**
VPFP CPI + 2	3.45%	0.618	6.45%	0.558	9.23%	2.287	20.37%	2.512	28.26%	3.396	32.30%	4.972
Investment Objective (CPI + 2%)					8.23%		14.34%		23.42%			
VPFP CPI + 4	4.15%	1.516	5.08%	1.411	7.22%	3.940	18.64%	3.946	30.35%	5.016	26.00%	7.025
Investment Objective (CPI + 4%)					10.34%		18.85%		30.79%			
VPFP CPI + 6	4.96%	2.466	4.65%	2.233	6.18%	5.980	18.97%	6.219	36.53%	7.390	19.15%	10.330
Investment Objective (CPI + 6%)					12.45%		23.45%		38.45%			
JSE All Share Index	7.79%	4.785	0.38%	4.332	-0.41%	11.606	15.61%	14.522	48.71%	17.131	-0.50%	20.168

(CPI Benchmark as at 30 November 2011)

Source: MoneyMate

If you have any questions about your investment portfolio or need any advice on financial planning please contact your VPFP financial advisor on the details provided on page 9.

We always welcome any feedback you may have on our newsletter or any other aspect of our business. Please email me at gholt@vpfp.co.za or call 011 803 7642 if you have any comments or questions.

Thank you for your continued support.

At your service…

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Our services include…

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

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