



Tax treatment of Retirement Fund benefits

Pension Lawyers Association
Seminar – June 2011

Janine Player

email: jplayer@oldmutual.com

PrivateWealth
management

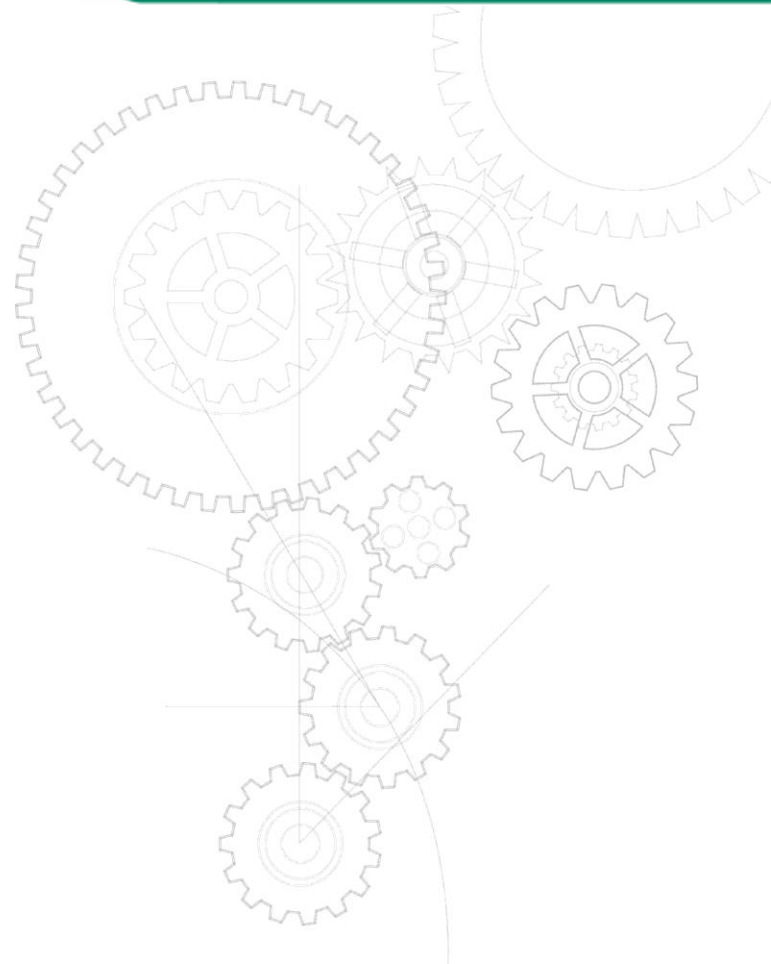


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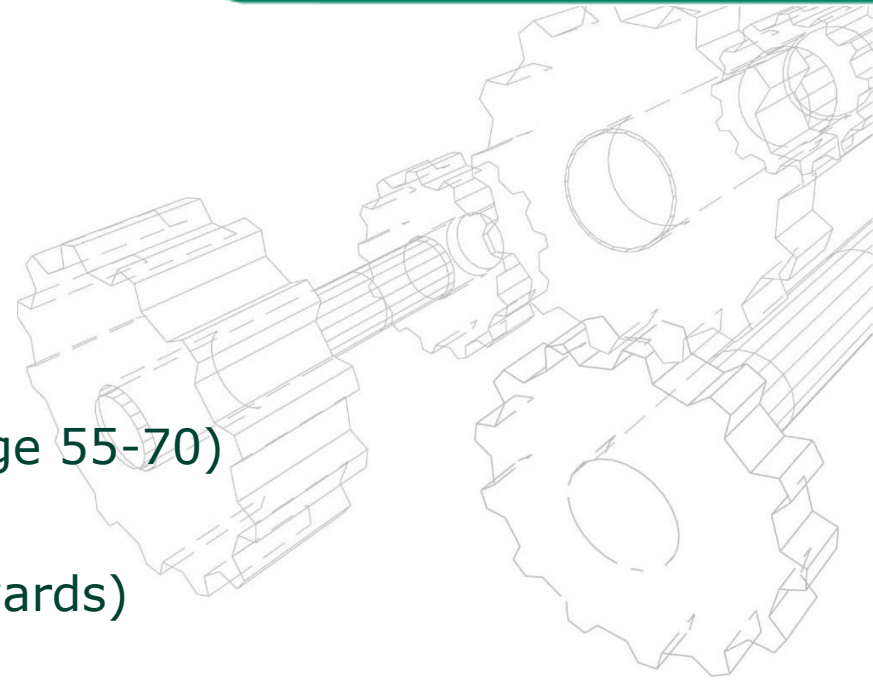
Agenda

- Joining a fund – types of funds
- Leaving a fund
 - Withdrawal
 - Divorce
 - Retrenchment
 - Retirement
 - Death
- Group Assurance policies
- Budget proposals



Retirement funds

- Occupational Funds (retirement age 55-70)
 - Pension and/or Provident fund
- Individual (retirement age 55 onwards)
 - Retirement Annuity
- Preservation (retirement age 55-70)
 - Pension Preservation
 - Provident Preservation
- Early retirement due to Disability
- Regulated by the FSB in terms of the Pension Funds Act and approved by SARS



Deductible Contribution – 2011 Budget Proposal to “roll all 3”

- Provident fund:
 - Employer-10% of employee’s Approved Remuneration (SARS practice is 20%)
- Pension fund:
 - Employee – Greater of 7.5% of taxable income or R1 750
 - Employer- 20% of employee’s Approved Remuneration (SARS practice)
- Retirement annuity:
 - Greater of 15% of taxable non-retirement funding income, or
 - R3 500 less allowable pension fund contributions,
 - Or
 - R1 750

Taxation of Retirement Funds

- Investment return in retirement funds are tax exempt as RF tax stopped in 2007
- RA's – Cannot withdraw prior to retirement unless emigration,
- Pen and Prov. Funds can withdraw total amount on leaving employer
- Pension Preservation and Provident Preservation funds allow one withdrawal prior to retirement



Taxation of Lump-sums paid from Funds

Para. 2 of the Second Schedule to the Income Tax Act

- the amount to be included in “gross income” of any person shall be:
 - 2(1)(a): lump sum benefits received as a consequence of retirement or death or retrenchment less allowable deductions
 - 2(1)(b)(iA): any divorce award deducted from his/her former spouse’s minimum individual award (the “person” is the non-member spouse) less allowable deductions
 - 2(1)(b)(iB): any transfer to any approved fund for the benefit of the taxpayer less allowable deductions
 - 2(1)(b)(ii): any other lump sum benefits received as a consequence of membership or past membership of a fund less allowable deductions

Allowable deductions from lump sum payments to Second Schedule:

- **on death, retirement or retrenchment, unless previously claimed, the following amounts are deductible:**
 - Previously disallowed contributions
 - Previously taxed divorce award transfers to any approved fund
 - Previously taxed transfers to approved funds
 - Previously taxed unclaimed benefits transferred to preservation funds
 - The tax-free portion of transfers from state funds
- **Gross lump sum benefit – deductions = taxable amount**
- **Then apply the Retirement Fund lump sum table**

Withdrawal from a fund

- Pre-retirement withdrawals from Pension and Provident funds allowed when member leaves employer.
- Pre-retirement withdrawals from an RA are not allowed, unless the member is emigrating
- Pre-retirement withdrawals are taxed according to the retirement fund lump sum tax table on withdrawal.



Retirement from a fund

- Provident Fund – any amount may be taken as a lump sum (taxable) and balance, if any used to purchase an annuity
- Pension and R.A. funds – maximum of 1/3rd may be commuted to a lump sum taxable amount.
 - Balance to purchase a compulsory annuity, unless-
 - The 2/3rds amount less than R50 000 or if the member is deceased.



Tax rates for lump sum withdrawal benefits- Pre-retirement withdrawal



Amount	Tax Rate
Not exceeding R22 500	0% of taxable income
Exceeding R22 500 but not exceeding R600 000	18% of taxable income exceeding R22 500
Exceeding R600 000 but not exceeding R900 000	R103 950 plus 27 per cent of taxable income exceeding R600 000
Exceeding R900 000	R184 950 plus 36 per cent of taxable income exceeding R900 000

Tax rates for lump sum retirement benefits- Retirement, Death and Retrenchment

Amount	Tax Rate
Not exceeding R315 000	0% of taxable income
Exceeding R315 000 but not exceeding R630 000	18% of taxable income exceeding R315 000
Exceeding R630 000 but not exceeding R945 000	R56 700 plus 27 per cent of taxable income exceeding R630 000
Exceeding R945 000	R141 750 plus 36 per cent of taxable income exceeding R945 000

Lump sum payments in terms of a divorce award

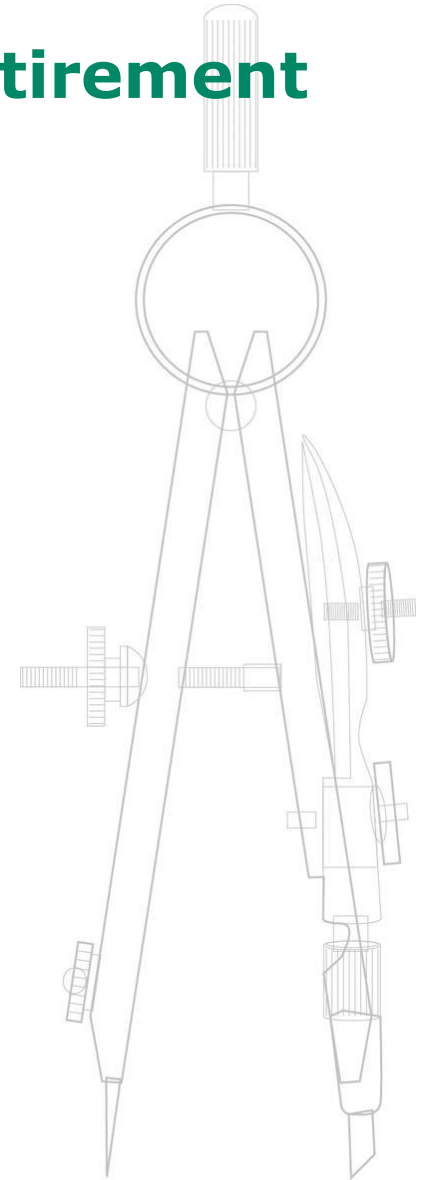
- Where the amount accrues to the non-member spouse after 1 March 2009:
 - Lump sum is taxed according to the retirement fund lump sum table less the portion of the divorce award that is transferred to an approved fund (eg: pension to pension / provident to provident)
 - The table applied is the withdrawal table unless amount transferred to another approved fund.
 - The amount of tax is deducted from the non-member spouse's allocation

Lump sum payments from a fund due to retrenchment

- Where the amount becomes payable on or after the 1 March 2009:
 - Lump sum is taxed according to the retirement fund lump sum table as a retirement benefit, less
 - the portion of the amount that is transferred to an approved fund (eg: pension to pension / provident to provident – including preservation funds)

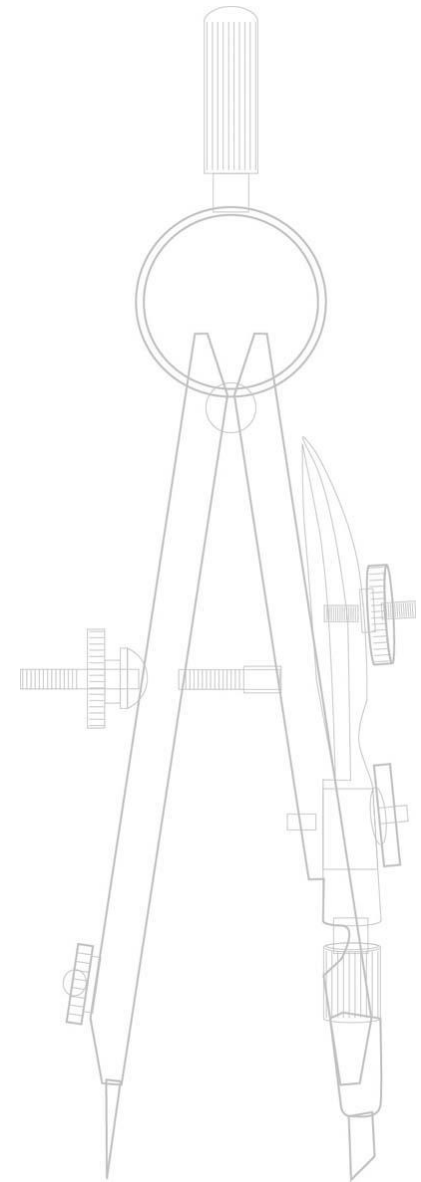
Severance, Retrenchment and Retirement Effective 1 March 2011

- R30 000 exemption (Sec. 10(1)(x)) for lump sums –abolished
- Average rating formula for lump sums (Sec.7A(4A)) abolished
- Lump sum severance/retrenchment benefits are taxed together with retirement fund lump sums according to the retirement table – cumulative
- Not possible to avoid tax by transferring the severance package paid by the employer to another approved fund



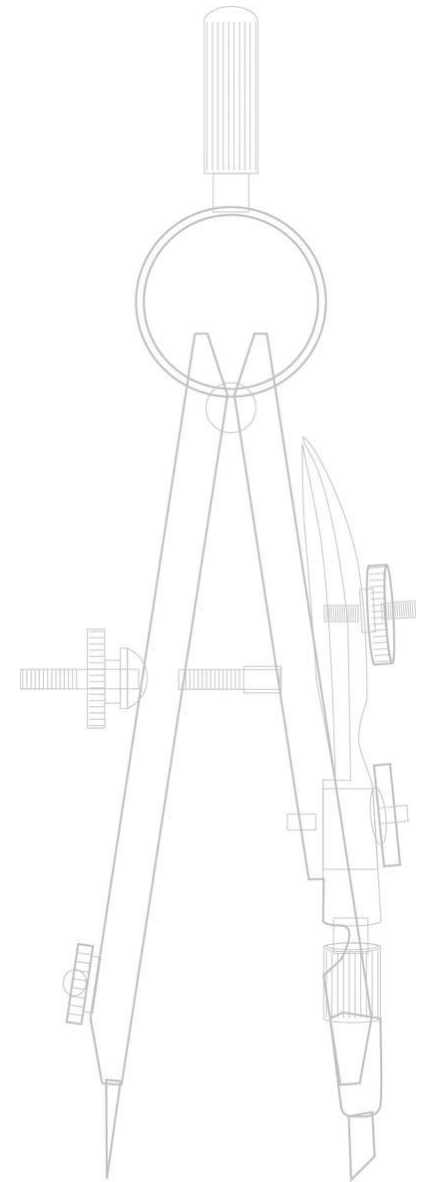
Preservation Funds

- A retirement fund to preserve retirement savings when changing jobs
- Able to accept transfers of allocations from funds to a non-member spouse in a divorce
- Able to accept money which has not been claimed by an exited member or a deceased member for 24 months or more



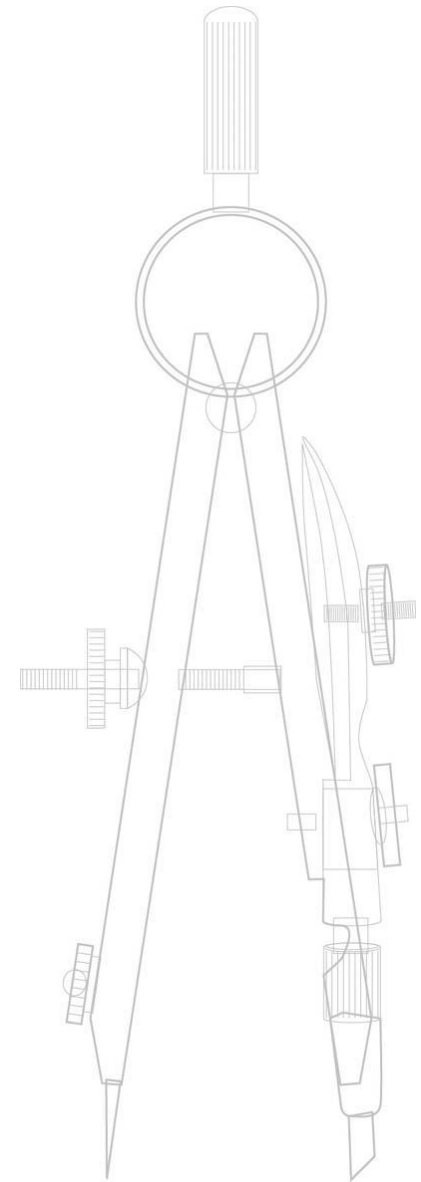
Preservation Funds

- WEF 1 March 2008 Preservations were defined in the ITA and needed approval by 30 September 2009.
- Transfers from pension funds to pension preservation funds , between RAs and from provident funds to provident or pension preservations – not taxable.
- Split transfers are not allowed except splits from a pension fund to an RA and a pension preservation fund.
- RF 1/2011 allows RA's to accept transfers from pension funds – ITA requires amendment before this is possible



Preservation fund withdrawals

- One taxable withdrawal allowed prior to retirement – taxable
- Withdrawal prior to transfer into preservation fund or deduction into Section 37D or withdrawal into a divorce award – not one withdrawal
- Transfers between preservation funds are not withdrawals, but currently FSB requires a section 14 transfer.
- Currently members of preservation funds who have taken their one withdrawal, cannot withdraw balance due to emigration prior to retirement



Aggregation of taxation of lump sum benefits

- All previous fund lump sum withdrawal benefits received after 1 March 09 and retirement/ retrenchment lump sum benefits received after 1 October 07 by the taxpayer is added to the current lump sum death / retirement / retrenchment benefit.
- A “hypothetical” Tax is calculated according to the Retirement Fund lump sum table on the combined amount
- Tax is calculated on previous lump sum amounts (regardless of reason) using current table and that amount is deducted from the “hypothetical ” tax amount
- The net amount is the amount of tax payable
 - Ref- Item 10(b) of Appendix 1 of the Income Tax Act

Example:

- Joe retires and commutes R2m of his pension fund. He receives a “golden hand-shake” of R1m. His average rate is 30% and his marginal rate is 40%.
- **Old Tax:**
 - R2m: R300 000 tax-free, R300 000 at 18%, R300 000 at 27%, R1.1m at 36% = **R531 000** (R135000 plus 36% on 1.1m)
 - R1m: R30 000 tax free and balance at 30% (R970 000 x 30%) = **R291 000**
 - **Total = R822 000**
- **New Tax:**
 - R2m + R1m taxed according to Retirement lump sum table.
 - 36% of amount above R945 000 ie: **R141 750** plus **R739 800**
 - **Total = R881 500**

Example cont:

- If Joe had been retrenched by a previous employer after 1 march 2011 and received a lump sum from his retirement fund of R1m taxed according Retirement lump sum scale =
 - R315 000 tax free (R0)+
 - R315 000 at 18%+ (R56 700)
 - R315 000 at 27% + (R141 750)
 - R55 000 at 36%= (R19 800)
 - R141 750+R19 800=**R161 550 tax**
- Then later he retires and receives the R2m lump sum from his pension fund plus a golden hand-shake of R1m.
 - He is already at the 4th tier of taxation at 36%
 - Total R3m taxed at 36%=**R1 019 850 tax**

Example cont:

- If Joe decides not to commute R2m of his pension and, instead, purchases a living annuity (RDDA):
 - R2m used to purchase a living annuity with no tax deducted
 - R2m (R1m original package+ R1m golden handshake) taxed at R141 000+ 36% \times of amount above R945 000 (R379 800)
=R520 800 (total tax (hypothetical), less original tax
 - **R161 550** (on first package)
- =R359 250**

Tax treatment of Life assurance benefits

- Fund owned policies (DC):
 - Benefit is outlined in the fund rules
 - Premium is paid by the fund and is built into the **deductible** Fund contributions made by the ER.
 - On death of a member the amount of insurance cover is paid to the fund and the lump sum paid to dependants is a combination of fund credit and life assurance benefit.
 - Lump sum is taxed according to the retirement tables as if the member had retired and the after tax amount is paid to dependants
 - Tax calculation will take account of prior lump sums taken by the member

Beneficiaries of lump sum benefits from a fund on death of a member

- Payment is in terms of Section 37C of the Pension Funds Act
 - Legal and financial dependants
 - Nominated beneficiaries considered last
- Lump sum is not part of the estate of the deceased member
 - Not subject to estate duty
 - Not subject to Executor's fees
- This presents an estate planning opportunity in respect of RA funds

2011 Budget Review Proposals effective 1 March 2012

- Contributions to a retirement fund by the employer on behalf of an employee deemed a taxable fringe benefit – not clear how “on behalf of” will apply
- Individuals may claim a deduction of a minimum of R12 000 and a maximum of 22,5% of taxable income to a max. of R200 000 pa. (reached at taxable income of R888 899 pa)
- Split of 1/3rd lump sum and 2/3^{rds} compulsory annuity for Provident Funds – not intended to apply to existing benefits
- Introduction of mandatory preservation
- Discussion documents to be published in July

Mandatory Preservation

- It may be a less optimal decision because:
 - Not all South Africans are covered by occupational funds or have RAs...
 - What about the rest?
 - Should auto-enrolment be considered?
- • What about people who **genuinely need access to these funds:**
 - Retrenchees – not sure whether mandatory preservation will apply
 - For education
 - Housing purposes
 - UIF is exhausted



if Budget proposals apply

■ Tax treatment of contributions

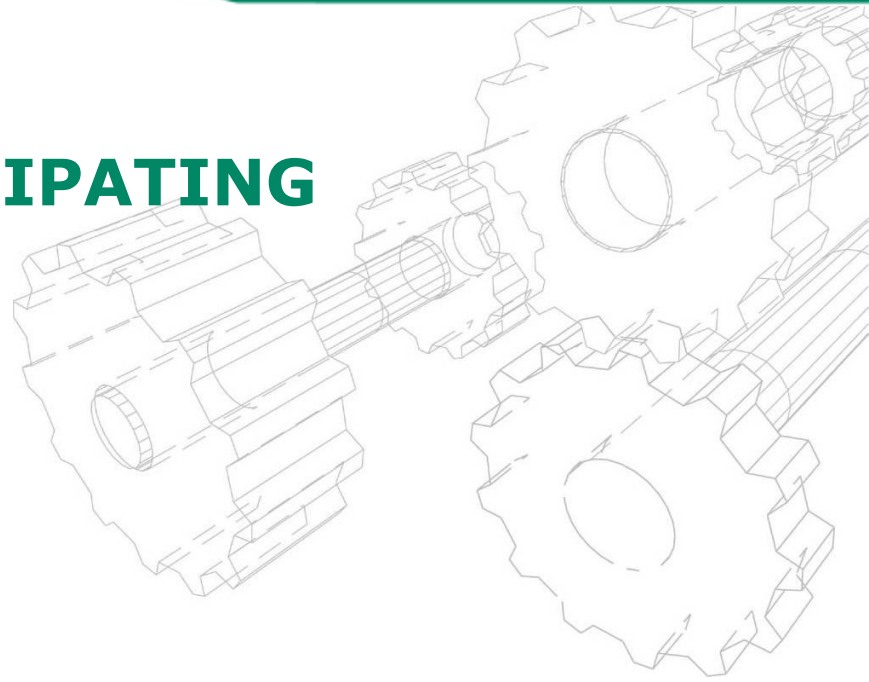
- Joe's taxable income is R900 000pa. He contributes 22.5% to an R.A. (total R202 500)
- He will only be able to claim a deduction of R200 000.
- However, it appears that the disallowed contribution will be allowed to be claimed in future years into 2nd schedule.

- Mary's taxable income is R51 000 pa. She may contribute and claim a deduction of R12 000pa rather than R 11 475(22.5% of R51 000)
- NB -his is an interpretation of proposals

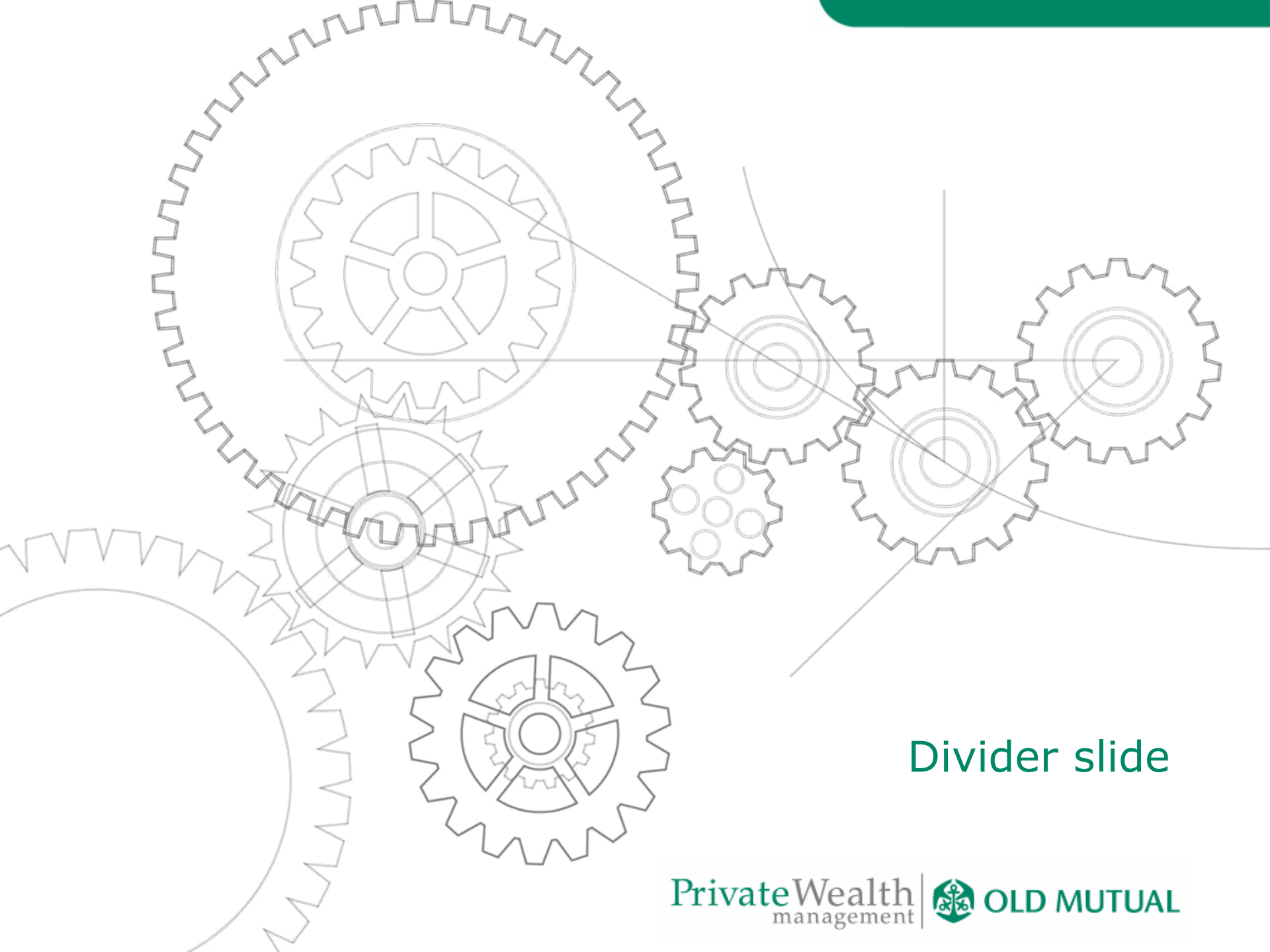
if budget proposals apply

- Same contribution scales for all types of fund at member level
- Anticipate the same retirement benefits structure from all types of funds
- Pre-retirement withdrawals will not be allowed and mandatory preservation will apply
- NB – all the above will incur Rule changes and member communication and education

THANK YOU FOR PARTICIPATING



—QUESTIONS?



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