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Retirement tax reforms

DEFINED CONTRIBUTION FUND TAX CHANGES
PENSION, PROVIDENT AND RETIREMENT ANNUITY FUNDS

WHAT IS THE “R350,000 LIMIT”?

A number of retirement fund tax reforms take effect from 1 March 2016.

This note deals with an important aspect of how this affects the contributions of some high earners.

From 1 March 2016, total contributions made to all pension, provident and retirement annuity funds will be treated the same for tax purposes.

All members will enjoy the same tax deductibility advantages no matter the type of fund.

There is however a limit to how much you can save in total out of pre-tax income in any tax year. More information is provided below.

THE NEW CONTRIBUTION TAX STRUCTURE

From 1 March 2016, contributions made by you or by your employer on your behalf to all defined contribution pension, provident and retirement annuity funds in any tax year will be tax-deductible up to 27.5% of the greater of “remuneration” and “taxable income”, with an annual deductibility cap of R350,000. Any contributions in excess of the cap can be carried forward for deduction in a future tax year, or eventually paid back to you tax-free as part of your benefits from the fund.

“Remuneration” is defined in the Income Tax Act and in short means all salary or wages and the value of other remuneration whether paid in cash or otherwise.

“Taxable income” is also set out in the Income Tax Act and in short is what is left from your total income from all sources after making any deductions allowed in the Act.

Any contributions that are used by a fund to pay for insurance benefits and fund administration costs will form part of the 27.5% limit.

HOW DOES THE R350,000 CAP WORK?

This will affect higher-earning members. Some examples:

- At a 10% contribution rate, you would reach the limit at an earnings level of R3,500,000;
- At a 15% contribution rate, you would reach the limit at an earnings level of R2,333,333;
- If you want to pay the full 27.5% of your earnings to a fund, you would reach the limit at earnings of R1,272,727.

In practice your "remuneration" and "taxable income" in respect of any tax year are only finally known when you are assessed by SARS after the end of the tax year. At that point, SARS will calculate the limit as it applies to you for the tax year – contributions that are within the limit will be allowed as a deduction for tax purposes, whereas contributions in excess of the limit will be disallowed, i.e. will not qualify to be deducted.

If you contribute in excess of the R350,000 cap in any given tax year, you can however carry forward the excess for deduction in a subsequent tax year.

It is possible that the R350,000 cap could be increased from time to time and this might positively affect your ability to claim relief on previously disallowed contributions carried forward.

If you reach retirement age and still have unclaimed contributions from after-tax money then a provision in the Income Tax Act ensures the return of your money without it bearing tax again. Thus if you take any such money as a lump sum it will be free of tax and even if you transfer your money into a pension product then the product provider will be able to return such money to you tax-free as part of your pension benefit.

SHOULD I LIMIT MY CONTRIBUTIONS TO R350,000?

It's something to which affected members should give some thought. Firstly, any contributions made from after-tax money, i.e. above the cap, will not be taxed when paid as a benefit. Secondly, retirement fund investments are not subject to capital gains tax, dividend tax or tax on interest. The build-up phase is thus enhanced. It is true, however, that you will ultimately pay tax on the investment growth when you receive it as a benefit, but this will usually be at beneficial tax rates compared to savings made outside the fund if you receive it as a lump sum. Even if you eventually take the benefit in the form of a pension, many pensioners earn a lower income in retirement than when they were working and the marginal income tax rate will be accordingly lower.

FINANCIAL PLANNING

Each taxpayer's circumstances will be different and you are advised to seek expert financial planning advice when making decisions about how much to contribute to any tax-approved retirement savings arrangement.

Your Robson Savage consultant will be glad to provide any further input you might require.