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Put it away!

HOW CAN WE MAXIMISE THE TAX EFFICIENCY OF CONTRIBUTIONS AFTER 1 MARCH 2016?

Changes to tax legislation provide opportunities for most retirement fund members to save more money tax efficiently.

> *We consider the changes and ask how members can optimise their fund savings in a tax efficient manner.*
>
> *This note is longer than our traditional "For Your Benefit" publications – that's because there's quite a lot to say about the subject!*

INTRODUCTION

With effect from 1 March 2016, the tax deductibility of contributions to all pension, provident and retirement annuity funds has been harmonised as follows:

- All contributions to all funds made by a member or by an employer on behalf of a member will be taken into account when assessing tax deductibility.
- The new limit for tax deduction is:
    - 27.5% of the greater of Taxable Income and Remuneration (as defined in the Income Tax Act) …
    - … subject to a limit of R350,000 per tax year
- Tax relief will in future be claimed only by the member.
- For the purpose of applying the new limit, employer contributions to any tax-approved funds will be deemed to be member contributions. This will be achieved by adding employer contributions to members' taxable income, whereafter the member will claim the tax relief.

In light of these changes, many funds and their members are asking about the possibility of making higher contributions to take advantage of the increased tax deductibility.

The purpose of this note is to look at how this can be achieved and the resulting practical implications.

We also consider the situation of members who will be affected by the R350,000 limit.

PUTTING MORE AWAY

Members of a *retirement annuity fund* can effectively make contributions of however much they wish. Such funds are however generally more expensive and restrictive than employer-sponsored pension and provident funds.

For members of *pension and provident funds* there are two different ways in which increased contributions could be achieved:

- The specification of higher contribution rates in a fund's rules (new contribution categories); or
- Making use of the ability to make additional voluntary contributions

All arrangements are of course subject at all times to compliance with the applicable fund rules. If necessary, rule amendments could be made to accommodate any chosen approach.

NEW CONTRIBUTION CATEGORIES

This would involve defining new contribution categories in a fund's rules. As an example, if a fund currently has 7.5% member contributions and 7.5% employer contributions, giving a total of 15.0%, then:

- A new category could be created with 20.0% member and 7.5% employer contributions, resulting in the highest available deductibility of 27.5%.
- Other categories could be created to give other, different total contribution rates in line with members' needs.

For those members who wish to contribute in any of the available categories that a fund chooses to offer, it would be necessary for them satisfy the eligibility criteria to be in that category. This might for example involve the member's terms and conditions of employment being amended to reflect the contribution category to which they belong.

Features of this approach:

- Members would need to commit to being able to contribute sustainably at the chosen higher rate. It would not be desirable for members to chop and change between contribution categories, indeed too much flexibility could endanger a fund's tax approval status.
- From a purely practical point of view and in order to avoid undue complexity, it may be desirable to limit the number of contribution categories to a carefully chosen few.
- The related question of how to define the salary on which contributions are calculated is dealt with further on.

ADDITIONAL VOLUNTARY CONTRIBUTIONS

The old situation of being able to claim up to R1,800 per annum of additional tax-deductible contributions to pension and retirement annuity funds has now fallen away.

If you are a member of a fund that has a provision in the rules permitting additional voluntary contributions, the way would be open to pay more into the fund up to the limits.

It would be advisable, however, to check if the employer's payroll system will include the additional contributions when calculating deductibility – if deductibility is not given in the month of payment, then the contributions would effectively be paid from after-tax money during the tax year, and the member would wait until the end of the tax year when the deduction would finally be allowed on assessment.

Features of this approach:

- Members may be better able to decide how much more to put into their fund as a Rand amount, rather than as a percentage of pensionable salary.
- The additional voluntary contribution approach would facilitate the commonly-encountered wish of members to put extra money away when they receive a bonus.

THE R350,000 LIMIT

Funds should consider the immediate introduction of a rule change limiting the Rand value of contributions to R350,000 in any tax year, for each contribution category. In this way members will not find themselves being forced to contribute after-tax money into their pension or provident fund.

We would suggest that such a rule change would best be worded along the lines of restricting contributions to “the maximum allowable for tax deduction purposes in terms of tax legislation from time to time”, rather than stating the actual Rand limit – this would avoid having to amend the rules if the limit is ever revised.

The combination of such a rule with another rule permitting additional voluntary contributions would allow members to contribute after-tax money if they wish, perhaps as part of a carefully considered financial plan.

OTHER CONSIDERATIONS

- ***Definition of ‘Pensionable Salary’ compared to ‘Remuneration’ and ‘Taxable Income’***

  Employers will be aware of what comprises ‘Remuneration’ as defined in the Income Tax Act but will not know what any employee’s ‘Taxable Income’ is going to be for any given tax year.

  Hence the payroll system should be able to apply deductibility up to 27.5% of Remuneration, subject to the R350,000 cap, at least as far as employment with that employer is concerned (an employee might have another job, in which case total Remuneration for the tax year will also not be known to each employer).

  Funds have to comply with their rules in any event, which means that contribution rates will have to respect the definition of ‘Pensionable Salary’ or ‘Fund Salary’ or whatever terminology is used for any given fund to describe the income on which contributions are based.

  Members for whom Taxable Income and Remuneration are different may have to make private arrangements through a retirement annuity fund in order to take full advantage of the increased limit.

  Funds should consider amending their rules to define ‘salary’ for contribution purposes to be Remuneration as defined in the Income Tax Act.

- ***Employers will not want their overall cost to increase***

  Under a ‘Total Cost to Company’ remuneration arrangement, members’ cost to company should not increase as a result of any structural contribution changes. All that will happen is that more of an employee's total remuneration will be directed to retirement fund savings.

If employer contributions are paid as an explicit element of remuneration, again the employer will not want to see the total cost rise.

- ***Insurance benefits and expenses***

  It must be remembered that the cost of any fund expenses and insurance premiums paid by a retirement fund out of contributions are included in the limit.

- ***Tax assessments***

  The final amount of the available tax deduction for a given tax year will only be known after the end of the tax year when the member is assessed for tax. Employers and funds will need to make it clear that they are not responsible in the event that a member fails to obtain tax deductibility in respect of any given contributions for whatever reason.

- ***Payroll systems***

  Companies, and specifically Human Resources personnel, will need to be aware of how exactly their payroll package operates so that they can assist staff to make tax-efficient contribution decisions. Different payroll systems may for example be able to cope with different levels of complexity around fund contribution structures. Fund rules must always, however, be borne in mind.

- ***Open ended voluntary contributions?***

  Where a member knows that they have excess tax deductibility arising from income that is not reflected in their Remuneration as seen by their employer, would the employer accept a request to allow the member to contribute more than the limit? It seems unlikely that payroll systems would be able to accommodate this, other than to allow extra contributions from after-tax money. The member would still obtain tax deductibility on assessment at the end of the tax year, but would not enjoy tax relief during the year.

- ***Contracts of employment***

  Employers need to carefully review contracts of employment in light of any changes that are implemented, and make any necessary amendments.

- ***Rules of funds***

  Funds' rules likewise need to be carefully reviewed and any amendments made.

WHAT DOES THIS MEAN FOR YOU?

Actions to be taken by boards of funds and employers:

Consider capping the total contributions for all contribution categories to R350,000 per tax year. *Consider introducing one or more new contribution categories to allow members to take full advantage of the available tax deductibility.*

Review your rules and the employer's payroll arrangements relating to Additional Voluntary Contributions.

Review the definition of 'salary' on which fund contributions are calculated.

It is suggested that boards of funds discuss the issues and suggestions raised in this note with their Robson Savage consultant in order to decide on any appropriate changes.

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