



## Legal Brief – Retirement Fund Related Tax changes

There have been a number of changes to taxation relevant to retirement funds and their members over the past six months. Additional changes are proposed in the latest amendment bill, some of which will apply retrospectively.

Insurance Zone in conjunction with Liberty Life Group Taxation have prepared a summary of these changes and compared them to them to current provisions where appropriate. This information is reproduced below to assist you in better understanding the implications for you and your members.

### **Abolition of Retirement Funds Tax (RFT)**

Retirement funds were subject to income tax on net rental, gross interest and foreign dividends at a rate of 9%.

This tax was abolished on 1 March 2007.

### **Deductibility of Contributions to Pension, provident funds and RA's**

Contributions by members of retirement funds and their employers are deductible within certain limits

No changes to deductibility of contributions have been made to date.

## **LUMP SUMS - RETIREMENT**

### **Commutation\* of lump sums on retirement - Pension funds and RA's**

Commutation refers to converting a future annuity or pension benefit into a lump sum.

1/3 of the total retirement benefit from pension funds and RA's can be commuted .

If the total retirement benefit is R25 200 or less it can be commuted in full. It has been proposed that if the total retirement benefit is R75 000 or less it can be commuted in full. Note that tax directives will still have to be applied for on these benefits. The effective date of this change still needs to be advised.

### **Calculation of tax-free portion of lump sums**

Currently Formulae A and B are used to calculate the tax-free lump sum. For retirement annuities only Formula B is taken into account.

In terms of Formula B the tax-free amount is limited to the greater of

- R 120,000 or
- R 4,500 x number of completed years of fund members, plus member contributions which were not allowed as a deduction.

Provident funds are subject to a minimum limit of R24 000.

A revised Formula B has been proposed

The tax-free amount is a flat R 300,000 plus member contributions which were not allowed as a deduction and contributions made to a public sector fund on or before 1 March 1998. These changes will apply to amounts accruing on or after 1/10/2007.

### **Tax rates on taxable portion of lump sums from Pension, Provident Funds or Retirement Annuity Funds**

Currently the taxable portion of any lump sum from these funds is taxed at average rates.

New flat tax rates have been introduced for the taxable portion of a lump sum. No rebates will be allowed when taxing the lump sum. Tax rates will apply to the lump sum as follows:

Amount	Tax Rate
First R300,000 of the lump sum	Tax free- see above
R300,001 to R600,000	18%
R600,001 to R900,000	27%
R900,001 plus	36%

These changes will apply to all amounts accruing on or after 1/10/2007

### **Simultaneous Retirement**

Currently the tax-free maxima apply to all the combined lump sums from retirement funds. The taxable portion of all the lump sums is taxed at average rates.

Under the revised legislation the tax-free amount is a life-time tax-exempt amount. Once the R 300,000 limit (and non-allowable contributions) is reached no additional tax-free amounts will be allowed.

The new flat tax rates will apply to the aggregate of the taxable portions of all retirement lump sums over the retiree's lifetime that are received on or after 1 October 2007.

## **LUMP SUMS- DEATH**

### **Calculation of tax-free portion of lump sums –Pension and Provident Funds**

Currently the same as retirement from a pension fund (apply formula subject to the maximum limit), but also subject to the minimum limit of the greater of

- R 60,000, or
- 2x salary earned in 12 months prior to death (salary over 12 month period is limited to R 60,000 )

New proposals revised Formula B only

The tax-free amount is a flat R 300,000, plus member contributions which were not allowed as a deduction and contributions made to a public sector fund on or before 1 March 1998. The new rules applies to amounts accruing on or after 1/10/2007

### **Calculation of tax-free portion of lump sums – Retirement Annuities**

Currently the tax-free portion of the lump sum is limited to the lesser of:

- The maximum limit as for retirement from an RA, or
- the greater of
  - o R60 000; or
  - o 1/3 of the member's contributions plus interest; or
  - o the equivalent of 1/3 of annuities that could have been commuted on the day prior to death.

The new legislation revised Formula B only The tax-free amount is a flat R300,000, plus member contributions which were not allowed as a deduction and contributions made to a public sector fund on or before 1 March 1998. These rules will apply to amounts accruing on or after 1/10/2007

### Taxable portion of lump sum

Currently the taxable portion of any lump sum from these funds is taxed at average rates.

New flat tax rates have been introduced for the taxable portion of a lump sum. No rebates will be allowed when taxing the lump sum. Tax rates will apply to the lump sum as follows:

Amount	Tax Rate
First R300,000 of the lump sum	Tax free- see above
R300,001 to R600,000	18%
R600,001 to R900,000	27%
R900,001 plus	36%

These changes will apply to all amounts accruing on or after 1/10/2007

### 'EXTRAORDINARY' LUMP SUMS

#### Statement of Intent payments

Statement of Intent payments relate to minimum values attributed to retirement fund members who have reduced /discontinued contributions or reduced the term to retirement-typically paid-up RA members.

Previously payments made after members have retired or died was subject to tax as lump sums in terms of the Second Schedule. Note that payments to current members were subject to tax when their benefits accrue i.e. on retirement, death, withdrawal or winding up of the fund.

Currently (after 1/1/2006) Statement of Intent payments made to RA members after they have retired or died will not be taxable. No directives need be applied for before the amounts are paid, but IT3(a)'s will still need to be issued. There is no change for payments made to current members.

#### Surplus payments

Surplus amounts arising from funds must be apportioned in terms of a surplus apportionment scheme. In terms of these schemes members could receive their portion either in cash or as an increase in their existing pension/annuities. The cash payments are taxable as lump sums in terms of the Second Schedule.

After 01/01/2006, Surplus payments made to retirement fund members after they have retired, died, withdrawn or after winding up of the fund will not be taxable. No directives need be applied for before the amounts are paid, but IT3(a)'s will still need to be issued.

Surplus payments to current members will be subject to tax when their benefits accrue i.e. on retirement, death, withdrawal or winding up of the fund.

### **Distribution of undisclosed profits**

Some fund administrators in South Africa have entered into arrangements where fund assets have been invested under the umbrella of one investment. The additional benefits ('secret profits') arising from negotiated interest rates ('bulking') were not passed to members.

These 'secret profits' arising from 'bulking' are now being distributed retirement fund members.

Payments made to retirement fund members after they have retired, died, withdrawn or after winding up of the fund will not be taxable. No directives need be applied for before the amounts are paid, but IT3(a)'s will still need to be issued.

Payments to current members will be subject to tax when their benefits accrue i.e. on retirement, death, withdrawal or on winding up of the fund.

## **PUBLIC SECTOR FUNDS**

### **Tax-free withdrawal and retirement payouts from 'Public Sector Funds'**

Lump sums from public sector funds where the member contributed before 1 March 1998 are partially tax-free on retirement or withdrawal in terms of Formula C. On transfer to a private sector fund, the full benefit is taxable and the tax-free nature of the public sector membership is lost.

After 01/03/2006 Formula C will remain, but the tax-free portion of a member's public pension fund benefit before 1 March 1998 will be preserved when transferred to a private sector fund.

The tax-free portion from public pension fund benefits before 1 March 1998 will apply to both retirement and withdrawal benefits from the private sector funds that they have been transferred to.

## **WITHDRAWAL BENEFITS**

### **Tax-free amount on withdrawal benefits- Pension and Provident funds**

Tax-free lump sums are limited to the greater of:

- R1800; or
- The member's own contributions not previously allowed as a deduction.

Single contributions transferred to other approved retirement funds will not be subject to tax. Nil directives must be applied for and Recognition of Transfers obtained.

No substantive changes have been made except for the treatment of the tax free portion on 'Public Sector Funds' on transfer after 01/03/2006.

### **Withdrawal benefits from Paid-up RA's**

Members of RA's are not entitled to 'withdraw' funds before age 55. Retirement is only permitted before age 55 on disability.

After 01/06/2007 and only once the Amendment Act is signed, Paid-up RA members with fund values less than R7000 will be allowed to withdraw at any time, even prior to age 55. Note that this change only applies to paid-up RA's.

### **Tax on withdrawal benefits**

No change, the taxable portion of a withdrawal benefit is still taxed at average rates.

### **DIRECTIVE APPLICATIONS**

#### **PAYE on retirement, death and withdrawal lump sum benefits**

Currently directives must be applied for all lump sum payments to members

From 01/10/2007 for amounts accruing after this date, no directives need to be applied for on lump sum retirement, death and withdrawal payments where the member/recipient has taxable income (excluding any lump sums) less than R40 000 (for the 2008 tax year) (i.e. the tax threshold in the preceding year of assessment). No reporting requirements for these payments have been provided. It is expected that IT3(a)'s would still need to be issued.

### **TAX ON ANNUITIES**

No change. Annuities are still taxed at marginal rates

### **MISCELLANEOUS CHANGES**

Previously taxpayers could claim a deduction for annuities provided to dependents of former deceased employees/partners of the taxpayer- section 11(m). The limit for the deduction was R2500.

After 01/03/2007, the deduction is now allowed in full.