

Retirement fund tax break if you are retrenched

Proposals to change the way in which the cash you withdraw from your retirement fund is taxed have now become law. We report on how the amendments may ease your tax bill or how they may result in your paying more tax.

October 31, 2009

By Laura du Preez

New tax rules for withdrawals you make from your retirement fund are now law and apply to any withdrawals made since March 1 this year.

The changes in the Taxation Laws Amendment Act, which was promulgated at the end of September, bring relief for anyone who has been retrenched since March 1 but penalise those who withdraw their retirement savings for any other reason.

When the National Treasury proposed the latest tax rates for lump sum withdrawals from retirement funds, the plight of people who lose their jobs through no fault of their own was highlighted. The proposals were then amended to provide some tax relief for people who are retrenched, by providing for withdrawals from their retirement fund to be taxed at the same rates as lump sums withdrawn from a fund at retirement are taxed.

This means the first R300 000 of their lump sum is tax-free; amounts greater than R300 000 but less than R600 000 withdrawn from your retirement fund will be taxed at 18 percent; any amount withdrawn that is greater than R600 000 but up to R900 000 will be taxed at 27 percent; and any amount greater than R900 000 will be taxed at 36 percent on a progressive basis.

You can preserve your retirement benefits without paying tax on them by transferring your benefits to another retirement fund, or if the rules of your fund allow, leaving them in your existing retirement fund.

To make use of the retrenchment tax concession, your employer must terminate your employment because it has stopped trading in the area or field in which you were employed, or it must make you redundant while reducing personnel generally or in a particular category.

The tax concession for people who are retrenched is aimed at those who will need to live on their retirement benefits while they are unemployed.

Ideally, however, you should preserve your retirement savings, and if you are able to survive retrenchment without tapping into your retirement savings, you should do so.

If you do not need the money, it is probably best to leave it in a retirement fund, where you cannot access it until you retire. But if you are considering withdrawing at least the tax-free amount, seek tax and financial advice from a qualified adviser.

On resignation

The new legislation that pertains to withdrawals from retirement funds means you should think very carefully about withdrawing money from your fund if you resign from a job.

Doing so will drastically reduce the amount you have available at retirement to ensure you can live comfortably in your later years, and pre-retirement withdrawals will now count against you at retirement: such withdrawals not only reduce the tax-free amount you can take at retirement but may also result in the amount you take as a lump sum at retirement being taxed at a higher rate.

The following table applies to lump sum withdrawals before retirement:

R0-R22 500: no tax
R22 501-R600 000: 18 percent
R600 001-R900 000: 27 percent
R900 001 and more: 36 percent

If you withdraw another lump sum from your retirement fund before retirement, you need to add the lump sum you are taking to any lump sums you have taken before and then apply the table. Thereafter, the same tax table must be

applied to the sum of the lump sums taken in previous years to calculate a notional amount of tax for the lump sums you have already taken.

The tax you calculate on the combined lump sums can then be reduced by the notional tax you have calculated on the lump sums taken previously.

The effect of doing this is that you enjoy the tax-free amount only once in your life and the more favourable tax brackets also apply only once - you do not, for example, enjoy R22 500 tax-free each time you withdraw a lump sum from a retirement fund.

At retirement, the following tax table must be applied to the total of the lump sum or sums you are taking at retirement and any lump sums you have taken previously:

R0-R300 000: no tax
R300 001-R600 000: 18 percent
R600 001-R900 000: 27 percent
R900 001 and more: 36 percent

Thereafter, the above tax table must be applied to the sum of the lump sums taken before retirement. The result of this second calculation will reduce the amount determined in the first calculation. The result is the actual tax you will pay on the lump sum taken at retirement.

Any lump sums you have taken at retirement before October 1 2007 and any lump sum withdrawals (on resignation or retrenchment) taken before March 1 this year will not be taken into account when the tables are applied to sums you take after March 1 this year.

Divorced couples

Where a lump sum is paid to the former spouse of a retirement fund member who was divorced after March 1 this year, the former spouse will pay tax at the above tax rates for lump sum withdrawals, unless the former spouse transfers the amount to a retirement fund.

If the former spouse takes the money in cash, this will count as a lump sum withdrawal when he or she retires and will affect the tax on any retirement lump sum withdrawals he or she makes at retirement accordingly.

Where the divorced retirement fund member was liable for tax on a withdrawal paid out to a former spouse in line with a divorce order (in cases where divorces and payments took place before March 1 this year), the withdrawal will not count against the member at retirement.

Application

The Taxation Laws Amendment Act was promulgated on September 30 but applies to lump sums taken since March 1.

The South African Revenue Service (SARS) has been taxing, and until next month will tax, lump sum withdrawals in line with the tax laws as they were before the amendment was promulgated. The tax you owe as a result of the changes to the law will be calculated when your tax return is assessed some time next year, and you will be paid a refund if necessary.

SARS is preparing to release the update to its tax directive system in line with the changes to the law on November 21.

If you are retrenched, consider asking your retirement fund if it can wait until SARS updates its system before applying for a tax directive on your lump sum withdrawal, otherwise you will be taxed on any amount above R22 500 and will have to wait until next year for a refund.

In line with the law as it stood before the latest changes, SARS has been taxing all pre-retirement lump sum withdrawals above R22 500 at your average rate of tax in the year you resign or in the preceding tax year (whichever is higher).

Regards
Eric Hempel