



DAVEY'S Locker



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Tax legislation & retirement philosophy

Dramatic changes invite reflection

by Tony Davey

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The upcoming February Budget Speech encouraged me to reflect upon recent, dramatic changes to the tax treatment of retirement fund benefits upon a member's retirement, death or withdrawal (see 63 TSH 2008 and 79 TSH 2009).

The favourable amendments pertaining to retirement and death are to be welcomed, both in their administrative simplicity and in their extension of tax-exempt thresholds. Nevertheless the recently introduced withdrawal tax regime, although generous, undermines the philosophy of saving for retirement.

Upon resignation, with the withdrawal benefit of the first R22 500 being tax free and the balance up to R600 000 taxed at only 18%, the temptation to encash rather than save is irresistible.

Even more enticing, a lump-sum benefit from a retirement fund withdrawn in circumstances of a *bona fide* retrenchment entitles a member to R300 000 tax free, pre-retirement.

Discussions with financial services providers confirm that the great majority of withdrawing members encash their retirement savings rather than transfer these tax free to a preservation fund.

It is ironic that it was only over

a year ago that preservation funds were formally recognized by way of a definition inserted into the Income Tax Act, specifically in order to encourage retirement fund members to preserve their retirement savings by way of a tax-free transfer upon withdrawal from a retirement fund into a preservation fund.

In effect, the past two successive years of tax amendments reflect contradictory philosophies on withdrawal benefits. The withdrawal and retirement tax tables, it is true, are inclusive of each other, in the sense that tax benefits upon pre-retirement withdrawals are taken into account and thus reduce a member's tax benefit upon retirement, but all the exercise achieves is to penalize a member when he or she is most financially vulnerable at retirement, instead of rather creating the disincentive to encash earlier in life upon withdrawal.

Ad hoc changes to our tax system should in my opinion be measured pre-enactment against a desired, consistent tax philosophy. It is to be hoped that the 2010 Budget speech will recognize and adopt a consistent approach.

