DAVEY'S Locker

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Relief coming for excess contributions

Nondeductible contributions to a retirement fund

by Tony Davey

Tax relief is provided when annual tax-deduction limits on retirement fund contributions are exceeded, in that a taxpayer can carry forward the nondeductible portion to the following tax year.

Ultimately, upon retirement, death or withdrawal, nondeductible contributions qualify for exemption, in addition to the R315 000 (death or retirement) or R22 500 (withdrawal pre-retirement) tax-exempt allowances granted against the commuted portion of a pension, pension preservation fund or retirement annuity.

Shortfalls

Yet this relief suffers from a shortcoming, in that it assumes that the maximum ⅓ commutation-amount of a retirement fund benefit is sufficient to absorb such excess contributions.

Furthermore, it effectively forces tax-conscious taxpayers to commute to the maximum extent allowed, in lieu of a full annuity, in order to avail themselves of the relief, which is available only against the commuted lump-sum component of a retirement benefit and not against the compulsory annuity portion, which is fully taxable.

For example, if the full value of a retirement fund benefit is R1,2 million upon retirement, a maximum of one-third, namely, R400 000 may be commuted. R315 000 is tax exempt, leaving only R75 000 to absorb excess contributions.

If such excess contributions were, say, R175 000, R100 000 tax relief would be forfeited.

New exemption coming

Effective as from 1 March 2013, nondeductible contributions will be exempt from income tax, irrespective whether retirement benefits are taken as a lump sum or as an annuity.

In practice, the exemption of excess contributions will be applied first to a lump-sum commutation and thereafter to the compulsory annuity, until extinguished.

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