DAVEY'S Locker

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Retirement funds

Budget proposals 2011

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The Minister of Finance has announced radical changes to the tax consequences of retirement fund contributions, effective as from 1 March 2012.

For the current 2011/12 year, the tax regime introduced with effect as from 1 October 2007 on lump-sum benefits arising upon retirement remains in force, as does the withdrawal formula introduced as from 1 March 2009, but the tax-free lump sum available upon retirement is increased to R315 000 (from R300 000), with consequential adjustments to the rating table, effective as from 1 March 2011.

The new rating table is shown next:

Taxable lump sum	Rate of tax
0–315 000	0% of amount
315 001–630 000	18% of amount above 315 000
630 001–945 000	56 700 + 27% of amount above 630 000
945 001 and above	141 750 + 36% of amount above 945 000

It is proposed that as from 1 March 2012 an employer's contribution to retirement funds on behalf of an employee will be a taxable fringe benefit in the hands of the employee. Individuals will from that date be allowed to deduct up to 22,5% of their taxable income for contributions to pension, provident and retirement annuity funds, with an annual maximum contribution of R200 000.

No doubt this 22,5% is the aggregate of an individual's current maximum deductible contributions to a pension fund (7,5%) and a retirement annuity (15%), no deduction being currently allowed to an individual for contributions to a provident fund.

On this revised basis, I deduce that the convoluted distinction between retirement-funding employment income (pensionable income) and non-retirement-funding employment income (non-pensionable income) will fall away, since the simple test is the base of taxable income to which the 22,5% is to be applied.

My sense of this proposal's weakness is that an employee would rather demand a salary increase and take the cash, in lieu of an employer's contribution subject to fringe-benefits tax.

In effect, the onus of providing for retirement is shifted to the employee, an idea which, given our culture of non-saving, is unlikely to work well, despite the 22,5% carrot.

To protect workers' savings,

government proposes to subject lump-sum withdrawals from provident funds to the one-third limit applying to pension and retirement annuity funds. The implementation date of any changes in the rules governing provident funds will be subject to consultation with trade unions and other interested parties, and vested rights will be protected.

I assume that the protection of vested rights means that the value of a provident fund benefit as at 1 March 2012 may be fully commuted, and that only future contributions and investment growth will be subject to a maximum one-third commutation, with the balance applied to the purchase of a compulsory annuity.

Since a compulsory annuity is fully taxable at an individual's marginal tax rate, while the lump-sum retirement tax table often results in a lower tax rate, I doubt that this proposal will find favour with individual taxpayers, despite the tax incentive of contribution deductions.

My suggestion is that all compulsory annuities should be taxed upon some concessional basis so as to alleviate the financial plight of most retired pensioners.