Business Accounting Network

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Going Beyond Accounting, Taking Business Forward

THIS MONTH'S FOCUS

New Retirement Reforms Is Here!

Good News for Taxpayers!

By Monique Sharland

The new retirement reforms have placed pension, provident and retirement annuity contributions under the same umbrella and are now collectively known as 'retirement funds'. There is broad consensus that the coordination and capping of tax deductions will be a simpler system, more equitable and progressive. National Treasury says, *"It will limit the tax deduction to very high-income earners and allow lower and middle income earners a bigger tax deduction".*

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Increased Tax Deduction on Retirement Fund Contributions

Taxpayers are now able to claim an increased deduction for contributions paid by both employers and employees of up to 27.5% of the greater of "remuneration" or "taxable income"(as defined in the income tax act), excluding annuities and retirement lump sums, and up to a cap of R350 000 per year from the 1st March 2016. The following table illustrates the amendments in tax deductions in the hands of the fund member:

<table>
<tr><th>Deduction Limits:</th><th>Up to 29 February 2016</th><th>From 1 March 2016</th></tr>
<tr><td>Pension</td><td>Lesser of
• R1 750 pa or
• 7.5% of RFI (retirement funding income)</td><td rowspan="5">One limit applies to all funds.

The lesser of:
• 27.5% of remuneration
• R350 000 per year</td></tr>
<tr><td>Arrears pension</td><td>R 1 800 per annum</td></tr>
<tr><td>Provident</td><td>No deduction</td></tr>
<tr><td>Retirement Annuity</td><td>Lesser of
• R1 750 pa or
• 15% of non-RFI (nonretirement funding income)
• R3 500 less pension deduction</td></tr>
<tr><td>Arrears retirement annuity</td><td>R 1 800 per annum</td></tr>
</table>

Employer Contributions to Retirement Funds Are Now Taxable in the Hands of the Employee

Previously, an employer's pension and provident fund contributions were not treated as a taxable fringe benefit in the hands of the employee. Under the new retirement fund tax regime, all retirement fund types will be treated in the same way. Contributions made by employers to pension, provident and retirement annuity funds on behalf of employees will all become a taxable fringe benefit in the hands of the employee.

The value of the fringe benefit will depend on whether the contributions are made to:

- A defined contribution fund, or
- A defined benefit fund (type of pension fund)

The fringe benefit value of a 'defined contribution fund' will be the actual company contributions towards the fund. If the employer contributes R900, then the fringe benefit value will be R900.

The fringe benefit value of a 'defined benefit fund' is more difficult to calculate as the value of contributions does not match the retirement benefit. The basic retirement benefit of a defined benefit fund is usually based on a formula that takes into account factors like the employees years of service and salary. If the fund is a 'defined benefit fund' then the fringe benefit value will be calculated using a special formula.

It is also possible to have a hybrid pension fund that has both 'defined benefit' and 'defined contribution' components.

If this is the case, the employer will rely on the valuator of the fund to provide the factor on which to calculate the monthly fringe benefit.

The tax effect of the fringe benefit is neutralised by the deduction of the retirement fund contribution within the prescribed limitations.

Preparation Required From Employers

Obtain the contribution certificate from your fund:

The fund will provide the employer with a contribution certificate in respect of each fund member category. This certificate will indicate the components of the fund, name of the fund, category factor etc.

Confirm type of fund:

Confirm with your fund whether the fund is a defined contribution (DC), defined benefit (DB) or hybrid fund. This should be indicated on the contribution certificate issued by the fund.

Category factor:

If the fund is a defined benefit or hybrid fund, the category factor is necessary to calculate the fringe benefit correctly. This should be obtained from the fund and entered into the applicable field on the payroll system.

Discuss with employees:

Employees need to know how and if they will be affected by the new rules. Discuss this with employees so that they will be prepared.

Only the employee may claim contributions (in respect of both the employer and the employee's contributions). However, if only the employee is contributing towards a retirement fund, the employer is under no obligation to deduct the employee's contributions when calculating PAYE on the employee's salary. In terms of the Income Tax Act, the responsibility and liability for deducting the correct amount of PAYE from employees rests with the employer. As the employer cannot be expected to verify the employee's retirement fund contributions made each month, it may be sensible not to include contributions made by employees when calculating PAYE. The employee can claim the tax deduction annually when they submit their IT12 return.

Most Taxpayers Are Going to be Better Off

The base of the greater of "remuneration" or "taxable income" on which the retirement fund's 27.5% tax deduction is calculated includes outside income (for example, rental income, alternative employment or investment income). Previously, such "outside" income could only be used to claim deductions on retirement annuity contributions.

Will Any Taxpayers Be Worse Off?

Employees who have benefited excessively from large employer contributions may be worse off as well as high earning individuals whose taxable income exceeds R1.27 million per year and who currently pay more than R350 000 (by way of their and their employer's contribution) will pay tax on the contributions above the cap and will accordingly see a reduction in their take-home pay.

What is the Hype Around the Retirement Reforms of Provident Funds?

Provident fund members are most affected by these changes. Currently, provident fund members can withdraw their entire savings as a cash lump sum on retirement or resignation. When the reforms come into effect, provident fund members younger than 55 years of age will only be able to cash in one-third of their provident fund, effectively switching provident funds to the pension and retirement fund model, thereby forcing the annuitisation of the remaining two-thirds, insofar as these benefits are paid out after March 1 2016 and exceed an amount of R247 500.

Provident fund members who are 55 years or older on 1 March 2016 are exempt from these provisions. However, only contributions made to the fund they belonged to at this date are exempt.

An amendment bill to postpone the commencement date of 1 March 2016 of compulsory annnuitisation to 1 March 2018 will be tabled in Parliament in the next few days (as per a statement released by National Treasury dated 16 February 2016).

South Africa has one of the worst savings rates in the world and it's getting worse according to the statistics released by the Reserve Bank. The retirement reform policy seeks to encourage employees to save and provide adequately for retirement.

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