

Legal update 13 of 2020: Retirement fund contributions & multiple withdrawals

A. Summary

This document deals with matters relating to retirement fund contributions and the tax on multiple withdrawals.

- Paragraph B explains the maximum deductible retirement fund contributions.
- Paragraph C set out how to calculate the maximum deductible retirement fund contributions.
- Paragraph D explains how contributions that did not qualify for deduction are dealt with in the next year.
- Paragraph E deals with disallowed benefits on the death of a person.
- Paragraph F explains how tax should be calculated on multiple withdrawals from retirement funds.

B. Maximum deductible retirement fund contributions

Sections 11F(1) and (2) of the Income Tax Act provides as follows:

11F. Deduction in respect of contributions to retirement funds.—

- (1) *Notwithstanding section 23(g), for the purposes of determining the taxable income of a natural person in respect of any year of assessment there must be allowed as a deduction from the income of that person any amount contributed during a year of assessment to any pension fund, provident fund or retirement annuity fund in terms of the rules of that fund by a person that is a member of that fund.*
- (2) *The total deduction allowed in terms of subsection (1) must not in a year of assessment exceed the lesser of—*
 - (a) *R350 000;*
 - (b) *27,5 per cent of the higher of the person's—*
 - (i) *remuneration (other than in respect of any retirement fund lump sum benefit, retirement fund lump sum withdrawal benefit and severance benefit) as defined in paragraph 1 of the Fourth Schedule; or*

- (ii) *taxable income (other than in respect of any retirement fund lump sum benefit, retirement fund lump sum withdrawal benefit and severance benefit) as determined before allowing any deduction under this section and sections 6quat (1C) and 18A; or*
- (c) *the taxable income (other than in respect of any retirement fund lump sum benefit, retirement fund lump sum withdrawal benefit and severance benefit) of that person before—*
 - (i) *allowing any deduction under this section and sections 6quat (1C) and 18A; and*
 - (ii) *the inclusion of any taxable capital gain.*

excluding retirement fund lump sum and severance benefit

OR

- (ii) **taxable income**
 - **including**
 - taxable capital gain
 - **excluding**
 - retirement fund lump sum
 - severance benefit
 - **before deducting**
 - 11F retirement fund contribution deductions
 - 6quat (1C) foreign income rebate
 - section 18A donation deduction
- (c) **taxable income, BEFORE DEDUCTING**
 - retirement fund lump sum
 - severance benefit
 - 11F retirement fund contribution deductions
 - 6quat (1C) foreign income rebate
 - section 18A donation deduction
 - inclusion of taxable capital gain
- (d) **limited** to actual contributions: employer + member.

This can be summarised as follows:

Lesser of:

- (a) R350 000
- (b) 27.5% of the higher of the person's
 - (i) **remuneration** as defined in Fourth Schedule,

C. Calculation of maximum deductible contribution

A template for the calculation of the maximum deductible contribution is provided on the last two pages of this Legal Update.

The following is an example of the calculation of the maximum deductible contribution.

°The taxable capital gain to be included in the taxpayer's taxable income is calculated as follows:

Sum of capital gains & (losses)
 less annual exclusion (R40 000)
 = aggregate capital gain / (loss)
 less / add assessed capital loss brought forward from previous year of assessment
 = net capital gain / (loss)
 x inclusion rate for individual (40% / 0.4)

Facts:

Salary	R950 000
Annual bonus	R 85 000
ER pension fund contribution	R 75 000
EE pension fund contribution	R 75 000
RA contribution	R 12 500
ER medical scheme contribution	R 10 000
Interest	R 50 000
Dividend (local)	R 45 000
Rental income	R200 000
Expenses in production of income	R 50 000
Sold holiday house, °taxable capital gain	R455 000

Salary	R950 000	
Bonus	R85 000	
Fringe benefits (ER pension fund cons)	R75 000	
Fringe benefits (ER medical scheme cons)	R10 000	
Remuneration [(b)(i)]	R1 120 000	27,5% = R308 000
Other income: rental, annuity	R100 000	
Interest	R50 000	
Dividends	R45 000	
GROSS INCOME	R1 315 000	
<i>Less exemptions</i>	R1 315 000	
interest (under 65)	(R23 800)	
dividends	(R45 000)	
INCOME	R1 246 200	
<i>Less deductions (s11a)</i>	(R50 000)	
Taxable income before 11F, 18A, 6quat (1C) deductions + BEFORE incl of taxable CGT [(c)]	R1 196 200	R1 196 200
<i>Plus taxable CGT</i>	R455 000	
Taxable income before 11F, 18A, 6quat (1C) deductions + AFTER incl taxable CGT [(b)(ii)]	R1 651 200	27,5% = R454 080
*Less 11F retirement fund contributions deduction	(R162 500)	
TAXABLE INCOME	R1 488 700	

* Lesser of: (a) R350 000

(b) higher of 27,5% of

(i) R1 120 000 = R308 000, or

(ii) R1 651 200 = R454 080

(c) R1 196 200

(d) **R162 500** (R75 000 + R75 000 + R12 500)

To qualify for maximum deduction of R350 000, increase contributions by another R187 500.

D. Disallowed contributions

Section 11F(3) of the Income Tax Act provides as follows:

- (3) *Any amount contributed to a pension fund, provident fund or retirement annuity fund in any previous year of assessment which has been disallowed solely by reason of the fact that the amount that was contributed exceeds the amount of the deduction allowable in respect of that year of assessment is deemed to be an amount contributed in the current year of assessment, except to the extent that the amount contributed has been—*
- (a) *allowed as a deduction against income in any year of assessment;*
 - (b) *accounted for under paragraph 5 (1) (a) or 6 (1) (b) (i) of the Second Schedule; or*
 - (c) *taken into account in determining the amounts exempt under section 10C.*

This means that a contribution in excess of the maximum deductible contribution (referred to as a previously disallowed contribution) will roll over to the next tax year, where it will then be:

- firstly, deducted against any lump sum benefit received by the member under paragraphs 5 or 6 of the Second Schedule to the Income Tax Act;
- secondly, qualify as an exemption against any income from a qualifying annuity under section 10C, and

- lastly, deducted under section 11F against any current income.

The taxpayer cannot choose how the previously disallowed contributions should be dealt with. He can for instance not decide not to apply it to a lump benefit because he wants to use the R500 000 tax free benefit on retirement.

Example 1

John contributed R400 000 to a retirement annuity fund and R200 000 to a pension fund in the 2019 tax year. Only R250 000 of those contributions qualified for deduction under section 11F.

The R350 000 that did not qualify for deduction, rolled over to the next tax year.

In the 2020 tax year, he contributed R50 000 to a retirement annuity fund. This is less than 27,5% of his taxable income. He retired from his pension fund and received a lump sum of R200 000 and a monthly annuity of R10 000 for three months from policy 1.

2020 tax year calculation:

Previously disallowed contribution	R350 000
Less lump sum deduction	R200 000
Less annuity income exemption	R 30 000
Less current year contributions	<u>R 50 000</u>
Total contributions not deducted	R 70 000
The R70 000 will roll over to the 2021 tax year.	

E. Disallowed contributions on death

Non-deductible contributions and estate duty avoidance is discussed in more detail under paragraph 6 of Legal Update 3 of 2020.

Only the position from 1 October 2019 will be dealt with here.

Section 3(2)(bA) of the Estate Duty Act provides as follows:

- (2) *“Property” means any right in or to property, movable or immovable, corporeal or incorporeal, and includes—*

- (bA) *so much of the amount of any contribution made by the deceased in consequence of membership or past membership of any pension fund, provident fund, or retirement annuity fund, as was allowed as a deduction in terms of paragraph 5 of the Second Schedule to the Income Tax Act, 1962 (Act No. 58 of 1962), to determine the taxable portion of the lump sum benefit that is deemed to have accrued to the deceased immediately prior to his or her death.*

This means that if a taxpayer who dies after 1 October 2019 made any contributions on or after 1 March 2016 that was allowed as a deduction against a lump sum benefit that is deemed to have accrued to him immediately before his death, those contributions will be included as property in his estate for estate duty purposes. By implication, if the beneficiaries choose not to take the benefit as a lump sum, but as an annuity instead, the disallowed contributions will not be included in the estate of the deceased for estate duty purposes. In this case, the beneficiaries would however also not be allowed to deduct the disallowed contributions against the annuity income under section 10C of the Income Tax Act. That deduction only applies to a qualifying annuity taken out by a member upon that member's retirement. It will not be available to subsequent annuitants. For example, if an annuitant had disallowed contributions of R100 000 but only used up R30 000 of his allowed exemption, the balance of R70 000 would not be available to his beneficiaries.

Example 2

This example continues from example 1 under paragraph D. In that example, R70 000 rolled over to the 2021 tax year.

In March 2021, John suffered a heart attack and then decided to contribute R2 000 000 to his retirement annuity fund without consulting his

financial adviser. In May 2021, he retired and took R1 500 000 as a lump sum benefit and purchased an annuity with the balance of R3 000 000. His annuity income from this policy 2 was R20 000 per month, starting on 1 June 2021. He also received rental income of R10 000 per month in the 2021 tax year. In August 2021, John passed away.

Income for 2021 tax year =	
8 x R10 000 from policy 1 (example 1)	R 80 000
3 x R20 000 from policy 2	R 60 000
6 x R10 000 rental income	<u>R 60 000</u>
Gross income	R200 000
Less s10C exemption*	<u>R 70 000</u>
Taxable income (before 11F)	R130 000
S11F deduction = 27,5% of R130 000	
=R35 750	
*Section 10C exemption of R70 000 contributions that did not previously qualify as deduction, rolled over from 2020 tax year.	
Amount to be included in John's estate as property for estate duty purposes:	
Current year contributions	R2 000 000
Less annuity income from policy 1	R 80 000
Less annuity income from policy 2	R 60 000
Less s11F deduction	<u>R 35 750</u>
Amount to be included	R1 824 250

F. Taxation of multiple withdrawals

Where a member makes more than one withdrawal from a retirement fund, it's not as simple as merely calculating the tax on the last withdrawal and then just deducting the tax paid previously.

A specific process must be followed for multiple withdrawals in respect of a -

- retirement benefit paid on or after 1 October 2007;
- a withdrawal benefit paid on or after 1 March 2009, and
- a severance benefit paid on or after 1 March 2011.

The steps of the process are as follows:

- Step 1: Add together the current taxable benefit and the previous benefits
- Step 2: Deduct disallowed contributions
- Step 3: Calculate tax on the total, using the tax table applying to the current exit type
- Step 4: Add together previous benefits
- Step 5: Deduct disallowed contributions on previous benefits
- Step 6: Calculate tax on the previous benefits, using the tax table applying to the current exit type
- Step 7: Deduct tax on previous benefits from tax on total benefits

Example

Peter resigned in April 2006. He received a benefit of R200 000.

In July 2016, he was retrenched. He took R300 000 of his benefit from his pension fund as a lump sum and transferred the balance of R700 000 to a pension preservation fund.

Due to financial difficulties, he lost his job in May 2020 and decided to take R500 000 from his pension preservation fund as his once-off pre-retirement withdrawal.

There were no disallowed contributions to his pension fund.

Step 1: Add together current taxable benefit + previous benefits
 $R200\ 000 + R300\ 000 = R500\ 000$

Step 2: Deduct disallowed contributions
R0

Step 3: Calculate tax on total, using current table
Tax on R500 000, using withdrawal tax table

18% of the amount above R25 000
= 18% of R475 000
= R85 500

Step 4: Add together previous benefits
R300 000

Step 5: Calculate tax on previous benefits, using current type table

Tax on R300 000, using withdrawal tax table
18% of the amount above R25 000
= 18% of R275 000
= R49 500

Step 6: Deduct tax on previous benefits from tax on total benefits

$R85\ 500 - R49\ 500$
= R36 000

The **resignation benefit taken** in 2006 is not taken into account, as it was paid before 1 March 2009.

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TEMPLATE FOR S11F CALCULATION

Salary	R
Commission	R
Bonus	R
Fringe benefits	R
<i>ER contribution to pension fund</i>	R
<i>ER contribution to medical scheme</i>	R
<i>Other fringe benefit</i>	R
REMUNERATION	R

Other income	R
<i>Voluntary annuity</i>	R
<i>Rental income</i>	R
<i>Other</i>	R
Interest	R
Dividends RSA	R
GROSS INCOME	R

Less exemptions	R
<i>Interest earned by RSA (section 10(1)(i))</i>	R
<i>Interest earned by non-RSA (section 10(1)(h))</i>	R
<i>Dividends from RSA companies (section 10(1)(k))</i>	R
<i>Bona fide scholarships/bursaries (section 10(1)(q))</i>	R
<i>Alimony/Maintenance receipts (section 10(1)(u))</i>	R
<i>Receipts from retirement funds</i>	R
<i>Capital portion of voluntary annuity (section 10A)</i>	R
<i>Section 12T (tax free investments income)</i>	R
INCOME	R

Less Deductions	R
<i>Section 11(a) expenses</i>	R
<i>Section 11(w) Key-man policies</i>	R
<i>Other</i>	R

TAXABLE INCOME (<u>before</u> s11F, 6quat 1C, 18A <u>before</u> TCG)	R
Plus: Taxable Capital Gain	R
TAXABLE INCOME (<u>before</u> s11F, 6quat 1C, 18A <u>after</u> TCG)	R
Less Deductions	R
<i>Retirement Fund contributions (11F)</i>	R
<i>Donations to PBO (section 18A)</i>	R
<i>6quat 1C - Rebate or deduction in respect of foreign taxes on income</i>	R
TAXABLE INCOME	R

ACTUAL Section 11F deduction R A v B v C v D

A) R350 000 R350,000

B) 27.5% of higher of R

i) *Rem excl RFLB RWB SB* R

ii) *Taxable income incl TCG excl RFLB RWB SB* R

C) Taxable income excl TCG excl RFLB RWB SB R

D) Actual contribution R

i) *From member* R

i) *From employer* R

WHAT CAN HIS MAX 11F DEDUCTION BE? R A v B v C