Legal Services

FINANCIAL SERVICES

ALEXANDERFORBES
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Tax deductions of retirement fund contributions after "T-day" on 1 March 2015

The Taxation Laws Amendment Act, 2013 changes the tax treatment of contributions and aligns the annuitisation requirements between pension, provident and retirement annuity funds.

This publication focuses on the tax deduction of retirement fund contributions on or after 1 March 2015. The tax treatment of contributions will allow for a single tax deductible contribution rate by employees irrespective of the contributor and the type of fund.

This change is aimed at having a uniform regime for all contributions and will be effective from 1 March 2015.

1. Current law relating to contribution deductions:

- Employer contributions [***section 11(l) of the Income Tax Act ('the Act")]***

Currently, employer contributions to pension funds, provident funds, medical schemes and benefit funds are tax deductible up to a limit of 20 per cent of an employee's approved remuneration.

Contributions made by the employer for and on behalf of the employee to pension, provident and benefit funds are tax exempt in the hands of the employees.

Employer contributions to retirement annuity funds are treated as a fringe benefit, generally leaving the employee to claim the tax relief on submission of the tax return.

- Employee/member contributions ***[section 11(k) and section 11(n) the Act]***

Currently, an employee may contribute to all or any one of a pension, provident and retirement annuity fund.

The allowable employee deductions are as follows:

- Pension Funds: up to 7, 5 per cent of taxable income.
- Provident funds: not tax deductible.
- Retirement annuity funds: limited to the greater of
  - R1 750 per year, or
  - R3 500 of pension fund contributions, or
  - 15% of non-retirement funding income.

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2. With effect from T-day on 1 March 2015, the law on contribution deductions will change.

The tax deductibility on contributions made to any type of retirement fund will be uniform but limited as follows:

- All employer contributions to pension, provident and retirement annuity funds will be an unlimited tax deduction for the employer *[amended section 11(l) of the Act, effective 1 March 2015].*
- This employer contribution will be a taxable fringe benefit in the hands of the employee.
- These employer contributions will be deemed to have been made by the employee and the employee can claim a deduction for that contribution.
- The employee is entitled to combine the employer and employee contributions to pension, provident or retirement annuity funds and claim a deduction up to 27,5% of the greater of remuneration or taxable income, subject to a maximum of R350 000 per year. [*section 11(k) of Act, effective 1 March 2015].*

3. Will the deduction of contributions take place monthly and will there be an impact on the employees take home pay?

As stated above contributions made by an employer will be deemed to be a contribution made by the employee.

- The monthly employer contribution to a pension or provident fund will be added to the employee's remuneration as a fringe benefit and PAYE will be paid monthly by the employee on that contribution.
- The employee contribution gets tax relief because there is a deduction from remuneration, on which the monthly PAYE is payable. This deduction is subject to the cap of 27.5 per cent of taxable income or R350 000 per year (whichever is lower). [*para 2(4) (a) of the Fourth*[1]*Schedule of the Act, effective 1 March 2015].*
- Section 11(k) must be read with para 2(4) (a) of the Fourth Schedule when considering the deduction of contributions. The employer contribution is deemed to have been made by the employee. The section 11(k) deduction referred to in 2(4)(a) of the Fourth Schedule includes the employer contribution as a result of the deeming provision under section 11(k) (iii).
- Hence, both the employee and employer (deemed employee) **contributions can be deducted when tax is calculated on a monthly salary.**
- This results in a tax neutral effect, and there should be NO NEGATIVE CASHFLOW impact on the employees take home pay after T-day, provided there have been no changes to pensionable salary immediately prior to 1 March 2015.
- For provident funds, the new regime may result in additional take home cash, if the contributions to the fund are now paid over to the fund, before tax.

The new regime for tax deductions is simpler, as employers can treat all contributions made to pension, provident and retirement annuity funds as a deductible employment expense and a fringe benefit for employees.

Fringe benefits for employer contributions are exempt from employees' tax deductions (PAYE), subject to limitations, resulting in a tax neutral effective for employees provided that their contributions are made within the allowable deduction limits.

The new regime gives the overall tax deduction to the individual taxpayer, who will be required to keep track of deductions that are allowed for each year tax of assessment and to track any roll-over's[2] for future years.

***If you need more information, please contact your consultant*.**

[1] Paragraph 4(a) of the Fourth Schedule of the Act states that "*any contribution by the employee concerned to any pension or provident fund which the employer is entitled or required to deduct from that remuneration, but limited to the deduction to which the employee is entitled under section 11(k) having regard to the remuneration and the period in respect of which it is payable"*

[2] *Where members contribute in excess of the prescribed limits allowed as a deduction each tax year, SARS will allow for these contributions which were previously disallowed as a deduction to "roll over". This "roll over" will apply year on year, until the members retire from the Fund. "The roll over" of contributions previously disallowed will be set off against member's retirement benefit commuted for cash first and where this is still a positive credit balance contributions previously disallowed, it will be applied to annuity payments. Section 11(k) (ii) allows for this and reads as follows:*

(ii) for the purposes of this paragraph, any amount so contributed in any previous year of assessment which has been disallowed solely by reason of the fact that it exceeds the amount of the deduction allowable in respect of that year of assessment is deemed to be an amount so contributed in the current year of assessment, except to the extent that the amount so contributed has been –

(aa) allowed as a deduction against income in any year of assessment;

(bb) accounted for under paragraph (5)(1)(a) or 6(1)(b)(i) of the Second Schedule; or

(cc) exempted under section 10C;