momentum

Employee benefits in the news

Treasury’s saving strategy is worth considering

FA News
10 April 2013
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According to Niel Fourie, public policy actuary at the Actuarial Society of South Africa, government is offering an increased incentive to save towards retirement – it’s not mandatory, but you’ll save on taxes.

How this works is that your tax-deductible contribution to your retirement fund will now be calculated according to your total remuneration package and not only your pensionable salary (which excludes your employer’s contribution to your pension or provident fund) and the maximum tax-deductible contribution percentage will be 27.5% across all retirement savings vehicles.

It’s a concession that has emerged from government’s discussion papers around retirement reform, particularly with regard to the issue of how retirement savings tax incentives could be improved.

Making the most of the maximum deduction

National Treasury says the maximum deduction allowed will be equal to 27.5% of whichever is greater – remuneration or taxable income. So, for example, if you are contributing to a pension fund you are allowed to deduct up to 7.5% of your total cost to company package from your taxable earnings every year to reduce the final tax amount, and your employer can boost your contributions by another 20% of your total cost to company package. You can therefore deduct up to 27.5% of your total remuneration, resulting in lower taxes.

This does mean, though, that you will have less take-home pay each month, because there has to be a trade-off. On the plus side, you’re electing to save more for retirement. It is proposed to be applicable from 2015 onwards, regardless of whether you contribute to a pension or provident fund or a retirement annuity (RA).

How will it work for pension and provident funds?

In the past, if you contributed 7.5% of your pensionable salary and earned an annual ‘cost to company’ salary of R500 000 a year, and your pensionable salary was 80% of your package, which is R400 000, you would be allowed to contribute 7.5% of R400 000 (that is, R30 000) to your pension fund. Your employer could contribute 20% of R400 000 (that is, R80 000). You would deduct R110 000 (R30 000 + R80 000) from R500 000 and take home R308 000 (that’s R390 000 less the tax bill of R82 000).

In terms of the new proposal, though, the 7.5% and 20% contributions would be offset against R500 000, no longer against the pensionable salary of R400 000. If you do the same calculations, the result is that you would take home R290 500 but only pay tax of R72 000 on the R362 500 that is taxable. From this, one can clearly see the retirement savings and tax advantage – despite the fact that your take-home will be R17 500 less than before.

What about a provident fund? Let's use the same example, assuming you belong to a provident fund.

Provident fund members can't claim the 7.5% tax deduction although employers can contribute up to 20% of that same R400 000 (or R80 000), leaving you with a tax bill of R92 500. In terms of the new proposal, an extra 7.5% contribution plus the 20% contribution from your employer is now based on the total 'cost to company' salary of R500 000, so you could deduct R137 500 from your salary, paying tax amounting to R72 000.

Again, you're incentivised to contribute more in order to pay less tax.

What about Retirement Annuities?
The current situation is that your RA contributions can be used to reduce your income (and therefore your tax) depending on which is the greater: 15% of taxable non-retirement funding income, R3 500 less any contributions made to a pension fund, or R1 750.

The benefits to self-employed clients will be the greatest, because if you're saving at the maximum tax-deductible percentages you'll be able to buy a roughly 80% bigger pension at retirement thanks to the proposed tax deductions.

Under current rules, if you contribute 15% of your income to an RA and you earn R500 000 a year, the investment in your RA would amount to R75 000 a year. Deduct this from your R500 000 and you're left with R425 000, which is taxable. Tax would be R94 000 and you would take home R331 000. But if you contribute 27.5%, once you've made the necessary deductions you're left with R362 500 that is taxable, so you'd pay only R72 000 tax.

Although your take-home pay would be R40 500 less in terms of the new system, you'd be propping up your retirement savings by R62 500 and your tax would be reduced to R22 000.

What financial advisors should know
Niel Fourie says financial advisors will appreciate that this maximum amount can be allocated across all retirement vehicles thanks to standardisation – previously, retirement vehicles were all taxed differently – which will make life easier.

"Previously, financial advisors would only be able to allocate a small part of a client's money to a RA if a client belonged to a company pension fund," he says. "But this will now change and clients can structure their savings at will, so if a client contributes only 10% to a pension fund he or she could contribute a lot more to an RA, making up the 27.5%. If a client prefers to keep take-home pay as it is, that's fine – but taking advantage of the saving would make sense for retirement. Ultimately, it means a bigger proportion of tax-free savings."

***Editor's thoughts**:*
Further consultation to National Treasury's consolidated paper '2013 Retirement reform proposals for further consultation' will take place during the year but it's expected that final proposals will come out by the end of the year. If you want to comment on the paper, be sure to do so in good time – the deadline is 31 May 2013. Issues around pre-retirement preservation, post-retirement preservation, governance and non-retirement savings, as well as broader reforms, are still up for discussion. Olano Makhubela, the chief director of financial investments and savings, will accept proposals at retirement.reform@treasury.gov.za. Comment below or email fiona@fanews.co.za.