STANLIB Multi-Manager

The Educator

February 2019

In The Educator, we address a number of topics with the ultimate goal of providing a better understanding of investing clients' money.

Part 3: Contributing towards your retirement fund(s) – contributing more than what is allowed for income tax deduction

In the final part of a three-part series we briefly discuss a number of factors to consider when retirement contributions are more than the amount allowed under Section 11F of the Income Tax Act. This series of articles focuses on Section 11F of the Income Tax Act – deduction of contributions to retirement funds.

Pre-retirement

Carried forward to future years of assessment

In the 2017/2018 tax year Mrs Selinda's retirement contributions qualified for a deduction of 27.5% of her taxable income. This amounted to R500 000. Since her deduction was capped at R350 0000, she qualified for a deduction of R350 000 in that tax year of assessment, with R150 000 rolled over to the current 2018/2019 tax year.

In the current year of assessment, the 2018/2019 tax year, her preliminary assessment shows that she qualifies for a deduction of R400 000. Since her deduction is once again capped at R350 000, the contributions rolled forward amount to R200 000 (150 000 + 50 000) i.e. **R200 000 of previously disallowed contributions**.

Contributing more than the amount allowed for under Section 11F allows you to rollover excess amounts

Non-discretionary savings vs discretionary savings

Mrs Selinda is contemplating whether she should continue to contribute more than the capped amount of R350 000 per year or reduce her contributions and instead, use them towards a discretionary savings vehicle such as a unit trust.

The answer will differ for investors, based on their financial needs, the amount they contribute in excess of the R350 000 cap, their term to retirement, tax brackets, appetite for risk, etc. It is therefore vital for Mrs Selinda to speak to her financial adviser and establish the best solution for her specific needs. Below are some of the options/factors that her financial adviser will bring to her attention.

Non-discretionary savings: contributing in excess of R350 000 cap

- If Mrs Selinda continues to contribute more than the amount allowed for under Section 11F of the Income Tax Act into a retirement annuity (RA), she will not receive immediate tax relief but will get the deduction in following years of assessment
- She will accumulate tax-free growth while invested in the RA
- If she is not financially astute and/or has a poor savings track record, it may be worth her while to continue contributing more than the capped R350 000 towards her non-discretionary RA savings vehicle
- Lastly, she may also decide not to take a lump sum benefit in excess of the R500 000# taxed at a nil rate, at retirement – following her inheritance from her late dad. This means she will not have to pay 36% lump sum tax as per the retirement tables, as she has adequate discretionary savings by way of her inheritance.

(#R500 000 only taxed at nil rate if previous lump sum benefits have not been taken)

Tax fee 'build up' allows for disciplined investing

Discretionary savings: contributing non-deductible contributions into another investment vehicle

If Mrs. Selinda decides to invest her non-deductible contributions into an investment vehicle other than an RA, such as a unit trust, all income generated from her unit trust will attract income tax as well as dividends withholding tax. Furthermore, any withdrawal would be taxed as a capital gain (excluding money market funds). While tax is a very important consideration, there are many other factors to take into account.

- She can optimise her tax benefits by investing into a tax fee savings account. This is unfortunately limited to a maximum of only R33 000 p.a
- Investing in a unit trust will allow her more flexibility. In contrast, Regulation 28 restricts RA's. Her needs analysis may show a capital shortfall at retirement and in view of that, will allow her to invest 100% in an equity (growth) fund in order to potentially overcome the shortfall by the time she retires
- Mrs. Selinda can only access her RA fund value at the age of 55 and even then, she can only access up to one third of her fund value in cash. Her discretionary savings allow her to withdraw at any stage from a unit trust account – her financial planning analysis may show the need for an 'emergency fund' to cater for short-term needs.

Tax benefits limited but provide full liquidity

At retirement

If Mrs Selinda elects to commute the lump sum she receives from her retirement benefit, it will be taxed in terms of the retirement tax table. However, in addition to the R500 000 taxed at a nil rate, she is allowed to deduct her previously disallowed contributions

STANLIB

MULTI-MANAGER

from her lump sum. Had she rather chosen to invest her non-deductible contributions into her unit trust account, then any withdrawal would be taxed as a capital gain.

Disallowed contributions can be deducted from lump sum amount taxable at retirement

In retirement

Any income derived from Mrs Selinda' s compulsory annuity will be taxed as income at her marginal tax rate. Though Section 10C of the Income Tax Act provides that any previously disallowed contributions that have also not been set off against a lump sum taken, may then be applied towards exempting annuity income received from compulsory annuities.

Example: Over the years, Mrs Selinda continued contributing more than the amount allowed for under Section 11F and built up previously disallowed contributions of R1 200 000. On retirement she elected to take only R1 000 000 of her retirement annuity as a lump sum and used the remaining amount to purchase an annuity. She will earn an annuity income of R600 000 in her first year of retirement.

Cash lump sum taxed	Compulsory annuity received
R1 000 000	R600 000
Less: disallowed contributions	Section 10C exemption R200 000*
(Limited to only) R1 000 000	(R1200 000-R1000 000)*
Taxable income R0	Income to be taxed R400 000

An exemption will be applied under Section 10C for disallowed contributions not set off against lump sums

Upon your death

Non-deductible contributions included in estate

Mrs Selinda's previously disallowed contributions would be property in her deceased estate and are subject to estate duty tax. This will be for all deaths occurring on or after 1 January 2016 and for all non-deductible contributions to retirement funds made on or after 1 March 2015. However, it is important to note that although her previously disallowed contributions are subject to estate duty, they do not create additional estate duty tax. The money was voluntary money to start off with and regardless of how the money was invested; it would be subject to estate duty in any case.

Disallowed contributions do not create additional estate duty cost

Mrs Selinda's wishes vs that of the trustees

Mrs Selinda's non-deductible contributions will be subject to Section 37C of the Pensions Fund Act, which specifies that trustees must apply their discretion as to who the dependants of the deceased member are and to distribute equitably among them.

If, however, she decides to invest her non-deductible contributions into a discretionary savings vehicle, the investment will be dealt with in terms of her will. In her will, Mrs Selinda may instruct how the proceeds of her unit trust account should be dealt with. This is not the case, however, with retirement funds.

In summary

- The reality is that the question of whether there is still rationale for making excess contributions to a retirement fund, will not impact the average salaried employee since their existing contributions will more than likely fall comfortably within the 27.5% deduction and the R350 000 cap.
- The question is whether you should contribute in excess of the amount you are entitled to as a tax deduction. If this is the case, deciding how to invest is not a simple decision as there is no right or wrong answer. And if you are in this fortunate predicament, there are many factors to consider. It is therefore important to engage with your financial adviser to help you make the decision.

STANLIB Multi-Manager is not a tax professional. Please seek the appropriate assistance/advice from a qualified financial or tax adviser.

Albert Louw CFP®

STANLIB Multi-Manager Head of Business Development
T + 27 (0)11 448 6211
M + 27 (0)82 829 7729
E Albert.Louw@stanlib.com

STANLIB Multi-Manager has taken care to ensure that all information provided herein is true and accurate. STANLIB Multi-Manager will therefore not be held responsible for any inaccuracies in the information contain herein. STANLIB Multi-Manager shall not be responsible and disclaims all loss, liability or expense of any nature whatsoever which may be attributable (directly, indirectly or consequentially) to the use of the information provided. STANLIB Multi-Manager, under its Category II and Category IIA FAIS licences, provides discretionary intermediary services and does not provide advice.

STANLIB Multi-Manager (Pty) Limited
Registration No: 1999/012566/07. A Financial Services Provider licensed under the Financial Advisory and Intermediary Services Act, 37 of 2002. FSP license No. 26/10/763