GRAY ISSUE

Let SARS help you pay for retirement

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The South African Revenue Service (SARS) wants to help you pay for your retirement.

The way in which they do this is by offering generous tax deductions when you make contributions to your retirement annuity (RA), pension or provident fund. On 1 March 2016, the tax deductions for retirement savings increased from 15% to 27.5% - which means you can now save more for retirement and get back more from SARS.

What else has changed?

You are now able to deduct your contributions to all retirement funds, with the maximum tax deduction you may make in a tax year limited to the greater of 27.5% of taxable income or remuneration (see **Definitions**), subject to an annual ceiling of R350 000. Contributions above this limit made directly by your employer are also now taxable as a fringe benefit in your hands.

If you contribute more than the limits, your extra after-tax contributions can be used to increase the value of any tax-free lump sum you take before or at retirement or to reduce the taxable portion of your living annuity income in retirement. Excess contributions in one year can also be carried over and deducted in the next year.

Remember that even if you are a member of company pension or provident scheme you can set up a retirement annuity to supplement your existing contributions. If it is a modern RA like those offered by Allan Gray you can stop and start your retirement annuity payments whenever you want and the investment is held in your name (even if you get it through an employer).

Why should you consider saving more than 15%?

You may be wondering what's in it for you, especially as saving more means less disposable income today. The important thing to remember is that retirement money is still your money, even if you can't spend it immediately. A well-researched rule of thumb is that a retirement income of 75% of your final salary just before you retire will allow you to live comfortably during retirement. You may think that you do not need to save a lot of money now in order to achieve this goal, as retirement is so far away. However, assuming a reasonable rate of return, a 30-year old who has not yet started saving for retirement needs to save about 22% of their salary to retire comfortably. This percentage increases to 30% for a 35-year old starting to save. It is never too late to start saving for retirement, but the older you start, the more you need to save to be able to retire comfortably.

Here is an example that demonstrates the value of starting early. Mr Smith, who is 30 years' old, earns an income of R300 000 per year and has a choice between keeping his retirement savings at 15% (like last year) or increasing it to the new maximum of 27.5%.

Scenario 1: Mr Smith's retirement savings contributions and tax bill from 1 March 2016 to 28 February 2017 if he sticks to 15%

Salary:	R300 000
Retirement contribution:	R300 000 x 15% **= R45 000**
Taxable Income:	R300 000 – R45 000 = R255 000
Annual tax paid:	R33 840 + 26% x (R255 000 – R188 000)
	= R51 260 – R13 500 (primary rebate)
	= R37 760

Scenario 2: Mr Smith's retirement savings contributions and tax bill from 1 March 2016 to 28 February 2017 if he increases to 27.5%

Salary:	R300 000
Retirement contribution:	R300 000 x 27.5% **= R82 500**
Taxable income:	R300 000 – R82 500 = R217 500
Annual tax paid:	R33 840 + 26% x (R217 500 – R188 000)
	= R41 510 – R13 500 (primary rebate)
	= R28 010

By taking advantage of the new tax deduction limits, Mr Smith can save an additional R9 750 on his annual tax bill. Although contributing more to his retirement savings means that Mr Smith's annual take-home pay will decrease, less of his money will be lost to tax. Remember that your retirement contributions are still your money, whereas tax paid is effectively the government's money.

Another way of looking at this is that by giving Mr Smith a tax bill that is almost R10 000 lower, SARS is paying 12% of his retirement contributions for the year. You too could benefit from this by considering an increase to your contributions.

Other things to consider

Like most countries, South Africa has a progressive personal tax regime. Our tax rates put a heavier burden for paying tax on those who should be able to afford it best, the highest earners. If you are lucky enough to be earning above the highest tax bracket, you will save 41% in tax on an extra rand saved in a retirement fund, as long as it is under the annual rand cap on deductions.

Not everyone can afford to save 27.5% of their income towards retirement, but the more you save the better your position will be in retirement.

If you are planning to make use of the tax concessions for this tax year by starting a new retirement annuity, or by making an additional contribution to an existing account, please make sure we receive your instruction, supporting documents and payment well in advance of the 28 February deadline.

Definitions

REMUNERATION	Remuneration is an amount paid to someone for work which has been done. It can be in the form of a salary, bonuses and commission, for example. It includes living annuity income and fringe benefits, but does not include amounts which have been earned by a person independently from their employer.
TAXABLE INCOME	Taxable income is the amount on which normal tax, at the applicable rate, is calculated for a tax year. SARS has confirmed that the following should be included in the taxable income amount to calculate the maximum annual tax deduction for retirement fund contributions: • Passive income, such as living annuity and interest income, and not only income earned from the carrying on of a trade. • The taxable portion of capital gains.

Commentary by Carrie Furman, tax specialist, Allan Gray

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