Beware of delayed tax penalty after withdrawal from a retirement fund

Members of retirement funds must beware of the tax penalty which awaits them when they retirement from a retirement fund if they had an amount taxed as a **retirement fund lump sum withdrawal benefit** before retirement. The following amounts are defined as **retirement fund lump sum withdrawal benefits**:

- an amount assigned as pension interest in terms of a divorce order granted on or after 13 September 2007 which is due and payable on or after 1 March 2012 to the non-member former spouse of a member of a fund and paid to such non-member spouse in cash;
- an amount transferred from a fund of which the person is a member to another fund for the benefit of that member if no deduction is permitted in respect of the amount transferred (e.g. transfers from a pension fund to a provident fund);
- an amount received by a member in consequence of his/her withdrawal from a fund before retirement (including a partial withdrawal where that is possible).

The following example illustrates the penalty

A divorcee woman had been allocated R600 000 as a pension interest from the pension fund of her ex-husband on 10 June 2014. She elected for the money to be transferred to her bank account by the fund. She has not received any taxable lump sum from a retirement fund before. Tax on the R600 000 was calculated according to the table applicable to **retirement fund lump sum withdrawal benefits** below.

(Table effective from 1 March 2014)

Taxable income from lump sum benefits (R)	Rate of tax (R)
0 – 25 000	0% of taxable income
25 001 – 660 000	18% of taxable income above 25 000
660 001 – 990 000	114 300 + 27% of taxable income above 660 000
990 001 and above	203 400 + 36% of taxable income above 990 000

Therefore the tax payable was R103 500.

When she retired on 30 September 2015 she commuted R1 000 000 of her pension fund benefits. The tax thereon was calculated as follows:

Pension lump sum	R1 000 000
Plus: Pension interest received in 2014	R 600 000
	R1 600 000

The tax on the aggregated amount is calculated according to the table applicable to **retirement fund lump sum benefits** below.

(Table effective from 1 March 2014)

Taxable income from lump sum benefits (R)	**Rate of tax (R)**
0 – 500 000	0% of taxable income
500 001 – 700 000	18% of taxable income above 500 000
700 001 – 1 050 000	36 000 + 27% of taxable income above 700 000
1 050 001 and above	130 500 + 36% of taxable income above 1 050 000

The tax on the aggregated amount is	R328 500
Less: tax on R600 000 according to the **retirement fund lump sum benefits** table	R 18 000
Tax on R1 000 000	R 310 500

Total tax payable for the two payments is therefore R414 000 (R103 500 + R310 500).

Note, it is not the actual tax which was paid on the R600 000 (i.e. R103 500) that is deducted from the tax on the aggregated amount, but a lesser amount of R18 000) which could even be nil if the amount taxed at the lump sum withdrawal table was R500 000 or less.

If she had the pension interest of R600 000 transferred to her pension fund there would not have been any tax payable on the transfer. If she then at retirement withdrew the R600 000 in addition to the R1 000 000 the tax on R1 600 000 would have been R328 500 which is R85 500 less than what she is paying now in total on the two amounts.[1]

The same problem presents itself when a person takes a withdrawal benefit from, for instance, a preservation fund of which he is a member and subsequently retires. This method of revisiting tax on a withdrawal benefit from a fund was devised by the legislator to discourage withdrawal of retirement benefits before retirement.

[1]**Note**: To keep the example simple commission and administration fees on the transfer of the R600 000 have been ignored.

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