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Legal update 7/2011

19 April 2011

TAXATION OF RETIREMENT FUND LUMP SUM BENEFITS (INCLUDING SEVERANCE BENEFITS)

Background: Legal Update 17 of 2009

In Legal Update 17 of 2009 we stated the following:

The Taxation Laws Amendment Act No. 8 of 2007 introduced the simplification of the calculation of tax on retirement benefits. The exemption amount was increased from R120 000 to R300 000 and the balance of the benefit was taxed in accordance with a special rates table as opposed to the previous complex formula. This applied in respect of the taxation of lump sum retirement and death benefits accruing after 1 October 2007. The Taxation Laws Amendment Act No. 17 of 2009 amended the Income Tax Act by deleting the definition of "formula B" in the second Schedule. This effectively removed the R300 000 exemption and made it part of the following table, applicable from 1 March 2009:

Taxable income from lump sum benefits	Rate of tax
Not exceeding R300 000	0% of taxable income
Exceeding R300 000 but not exceeding R600 000	R0 plus 18% of taxable income exceeding R300 000
Exceeding R600 000 but not exceeding R900 000	R54 000 plus 27% of taxable income exceeding R600 000
Exceeding R900 000	R135 000 plus 36% of taxable income exceeding R900 000

Retirement benefits will be taxed on an accumulated basis, which means that all withdrawal benefits received on or after 1 March 2009 and retirement benefits received on or after 1 October 2007 have to be taken into account in determining the tax payable on a specific retirement benefit.

Taxation of severance benefits

Retirement fund lump sum benefits and retrenchment lump sum payments ("severance benefits") are now treated equally. This was announced in the 2010 Budget Speech. Various changes to legislation resulted in an implementation date of 1 March 2011. This was for these types of benefits that accrue on or after 1 March 2011. The previous tax rate table (incorporating the R300 000 tax-free lump sum amount) is therefore still applicable to benefits that accrue prior to 1 March 2011.

In our Legal Update 7/2010 we stated that –

A new definition for severance benefit has been inserted into the Act. This relates to the payment of a lump sum benefit in respect of an employee over 55 years who loses their job –

- *due to medical disability;*
- *their employer's ceasing business; or*
- *due to retrenchment.*

The intention was that the R30 000 retrenchment exemption be aggregated with the R300 000 tax free amount payable from a retirement fund upon retrenchment. However, this is not included in this Amendment Act and in fact the definition of severance benefit is not used anywhere else in the Amendment Act. Whether this is an oversight or deliberate is not clear.

SARS have confirmed that the “severance benefit” definition will be added to the new rates of tax in the next Taxation Laws Amendment Act. They didn't add it in the previous TLAA because the Minister only announces the rates in February of each year.

This means that if the member's severance benefit from an employer is R400 000 and a tax directive is applied for, the tax-free amount would be R315 000 and the R85 000 will be taxed according to the tax table. At the same time the member becomes entitled to a retrenchment benefit in terms of the fund rules. The total lump sum from the fund will be taxed as the tax-free amount of R315 000 was exhausted by their severance benefit from their employer, taking into account the aggregation principles.

The SARS system is already giving effect to the above.

Revised tax rate table

From 1 March 2011, government has increased the tax-free lump sum benefit upon retirement from R300 000 to R315 000. The revised rates for the taxation of lump sums upon retirement and severance benefits are set out below.

Taxable income from lump sum benefits	Rate of tax
Not exceeding R315 000	0% of taxable income
Exceeding R315 001 but not exceeding R630 000	R0 plus 18% of taxable income exceeding R315 000
Exceeding R630 001 but not exceeding R945 000	R56 700 plus 27% of taxable income exceeding R630 000
Exceeding R945 001	R141 750 plus 36% of taxable income exceeding R945 000

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