momentum

Legal update

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Legal Update: Tax changes to the Income Disability benefit and the impact on retirement fund contributions

Summary
From 1 March 2015 the way in which the Income Disability Benefit is taxed, will change. If a member receives a disability income and their retirement fund contributions are paid from that disability income, this change will also have an impact on the tax deductions that they will receive on their retirement fund contributions.

Current Position
If an employer pays a premium in respect of an income disability benefit on a member's behalf, the member is effectively in a tax neutral position. This is because although the premium paid on their behalf is a taxable fringe benefit, the premium is also simultaneously allowed as a tax deduction. If the member becomes disabled and claims in terms of their income disability policy, they will be taxed on the disability income that they receive.

If their own pension fund contributions are paid from their income disability benefit, they receive a tax deduction which is capped at 7.5% of their retirement funding income per year on their contributions. If they receive their disability income via their employer and the employer is required or entitled to deduct their contribution, then they will receive the deduction in respect of their own contribution towards the pension fund in the same month. However, if their disability income is paid to them directly, then they will have to wait until the end of the tax year to receive the deduction as the employer did not deduct their contribution.

Position from 1 March 2015
From 1 March 2015, the member will still be taxed on the premium paid for an income disability benefit. However, the premium contributed on their behalf by their employer will not be tax deductible anymore. If they become disabled and claim, the income disability benefit, when paid out, will not be taxed.

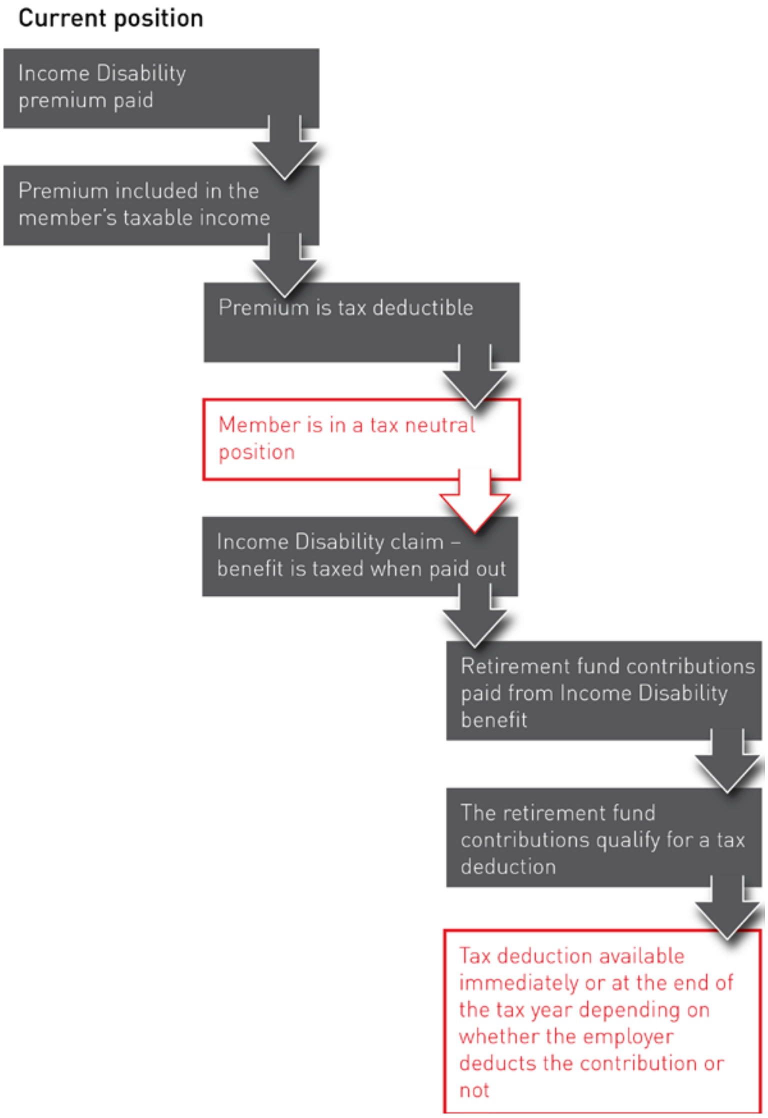
If the member's retirement fund contributions are paid from their income disability benefit, they will still qualify for a tax deduction on their contributions. However, because the income disability benefit is paid out tax free, the member will not be getting the deduction immediately unless they receive other taxable income to which the deductions could be applied. Currently, if the member has no other taxable income, the qualifying deductions will be carried forward and will be deducted when the member becomes entitled to a retirement benefit or if a death benefit becomes payable in respect of the member.

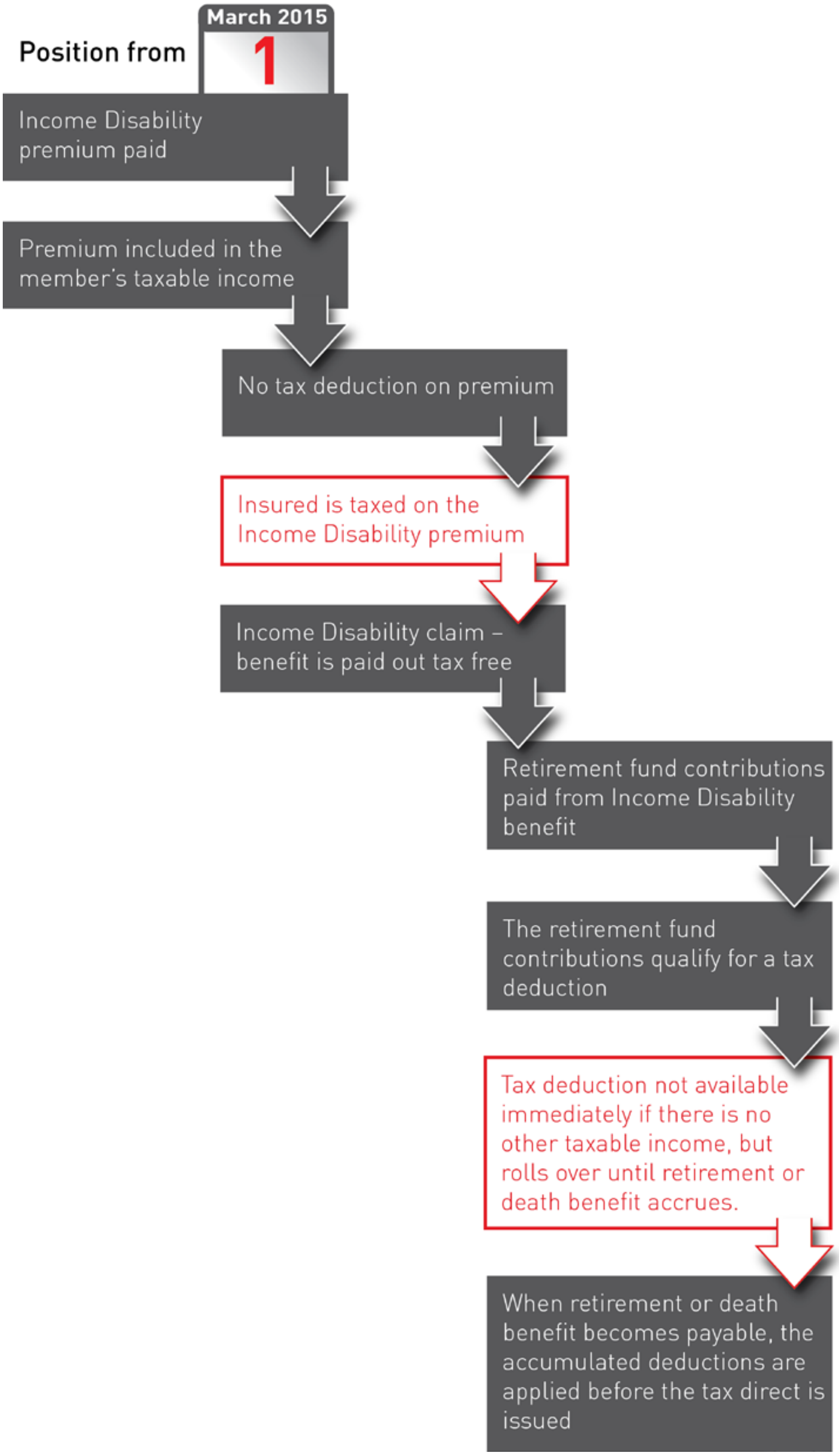
Once the member retires and receives a retirement benefit, the deductions that were carried forward will apply to all the contributions that were not previously deducted before a tax directive is issued.

Impact on employer
Employers need to be aware that their payroll processes will change.

Currently, the employer is required to reflect the fringe benefit, i.e. the income disability premiums paid on behalf of the employee and the corresponding tax deduction on the employee's tax certificate and IRP5. From 1 March 2015, there will be no corresponding deduction; only the fringe benefit will be reflected.

The change can be illustrated in the following way.





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