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Calculation of tax payable on lump sum benefits

Background

The South African Revenue Service (SARS) issued an updated Guide on the Calculation of the Tax Payable on Lump Sum Benefits (the Guide) on 16 October 2018. This Guide can be accessed here or on the SARS website www.sars.gov.za. The Guide clarifies how the tax payable on lump sum benefits is calculated. We have summarised the Guide, showing practical examples of the calculations of the tax payable from an occupational or preservation fund.

1. Income Tax Act

A member of a retirement fund becomes entitled to a lump sum benefit when his membership of the fund ends. The tax payable on the lump sum benefit is determined by the Second Schedule to the Income Tax Act. The tax on the lump sum benefit is set out in the withdrawal and retirement tax tables which are available here or on the SARS website.

There are two lump sum benefits that are payable by a fund:

- Withdrawal benefit: a benefit that is paid to a member when the member exits the fund before his normal retirement age for any reason other than death, retirement or retrenchment, for example, resignation, withdrawal and divorce.
- Retirement benefit: a benefit that is payable because of the member's death, retrenchment or retirement.

Any withdrawal or retirement benefits the member previously received or which accrued to him are taken into account when calculating the tax payable on a lump sum. A member *receives* a benefit on the day it is actually paid to him, while a benefit *accrues* to a member on the date on which he elects to receive the benefit and becomes unconditionally entitled to it in terms of the rules of the fund. If the member had any contributions that were not previously allowed as deductions, those are also taken into account by SARS

Severance benefits are also taken into account when determining the accumulated lump sum to calculate the tax payable. A severance benefit is an amount that an employer pays to an employee when an employee loses his job due to the termination, loss or cancellation of that person's office, employment or appointment (also called a retrenchment benefit).

2. Calculation of tax payable

Calculation of tax payable on a lump sum benefit is done cumulatively. This means that the following lump sums the member previously received or which accrued to him are taken into account when determining the tax that applies to the current lump sum benefit:

- Retirement benefits received or accrued on or after 1 October 2007.
- Withdrawal benefits received or accrued after 1 March 2009.
- Severance benefits received or accrued on or after 1 March 2011.
- All previous lump sum benefits received will be subjected to the rates of tax (retirement or withdrawal) that apply to the current lump sum benefit.

To calculate the tax payable on the current lump sum amount, the following steps must be followed:

Step 1

Determine the total taxable income of all lump sums received or accrued. This includes the current lump sum benefit:

- Add together the current withdrawal benefit, retirement benefit or severance benefit with:
  - all previous withdrawal benefits received or accrued on or after 1 March 2009;
  - all previous retirement benefits received or accrued on or after 1 October 2007, and
  - all previous severance/retrenchment benefits received or accrued on or after 1 March 2011.
- Deduct any contributions that were previously not allowed.

Step 2

Apply the tax applicable to the current lump sum to the total lump sum amount calculated in Step 1.

Step 3

Determine the total taxable income of all previous lump sums (excluding the current lump sum) by:

- adding together:
  - all previous withdrawal benefits accrued on or after 1 March 2009;
  - all previous retirement benefits accrued on or after 1 October 2007, and
  - all previous severance/retrenchment benefits accrued on or after1 March 2011), and
- deducting any contributions that were previously not allowed.

Step 4

Apply the tax applicable to the current type of lump sum to the total lump sum amount calculated in Step 3.

Step 5

Deduct the tax calculated in Step 4 from the value in Step 2 to determine the tax payable on the current lump sum.

3. Practical examples

3.1. Member receives a withdrawal benefit and didn’t previously receive any lump sum benefits

Ms F exits the ABC Provident Fund on 31 January 2019 and chooses to have her benefit of R45 000 paid to her as a lump sum.

Step 1

Determine the total taxable income of all lump sums received or accrued.

• Current benefit	R45 000
• All withdrawal benefits on or after 1 March 2009	R0
• All retirement benefits on or after 1 October 2007	R0
• All retrenchment benefits on or after 1 March 2011	R0
• Total taxable income	R45 000

Step 2

Apply the tax that applies to the total taxable income in step 1.

The tax table is:

Taxable income from lump sum benefits	Rate of tax
0 – R25 000	0%
R25 001 – R660 000	18% of the amount above R25 000
R660 001 – R990 000	R114 300 + 27% of the amount above R660 000
R990 001 and above	R203 400 + 36% of the amount above R990 000

- The R45 000 falls in the second tax bracket as highlighted above. The tax is calculated as follows:

  18% of the amount by which the R45 000 is more than R25 000
  = 18% of (R45 000 – R25 000)
  = 18% of R20 000
  = R3 600

- The first R25 000 of the R45 000 is tax free while R3 600 tax is payable.

3.2. Member receives a retirement benefit and previously received a withdrawal benefit

On 31 January 2019, Mr T retires from the DEF Provident Fund. His retirement benefit is R1 500 000 and he elects to receive the full benefit as a lump sum. He has R200 000 of excess contributions that were previously not taken into account. He received a withdrawal benefit of R250 000 from the RST Provident Fund on 31 January 2010. Tax of R40 950 was paid on that benefit.

Step 1

Determine the total taxable income of all the lump sums received or accrued.

• Current retirement benefit	R1 500 000
• All withdrawal benefits on or after 1 March 2009	R 250 000
• All retirement benefits on or after 1 October 2009	R0
• All retrenchment benefits on or after 1 March 2011	R0
• Less: excess fund contributions	(R200 000)
• Total taxable income	R1 550 000

Step 2

Apply the tax that is applicable to the total taxable income in step 1.

The tax table is:

Taxable income from lump sum benefits	**Rate of tax**
0 – R500 000	0%
R500 001 – R700 000	18% of the amount above R500 000
R700 001 – R1 050 000	R36 000 + 27% of the amount above R700 000
R1 050 001 and above	R130 500 + 36% of the amount above R1 050 000

The R1 550 000 falls in the last tax bracket as highlighted above. The tax is calculated as follows:

R130 500 + [36% of (R1 550 000 – R1 050 000)]

= R130 500 + (36% of R500 000)

= R130 500 + R180 000

= R310 500

Step 3

Determine the total taxable income of all lump sums previously received or accrued

- All withdrawal benefits on or after 1 March 2009 R250 000
- All retirement benefits on or after 1 October 2007 R0
- All retrenchment benefits on or after 1 March 2011 R0
- Previous lump sums R250 000
- Less: excess fund contributions (R0)
- Total taxable income of previous lump sums R250 000

Step 4

Apply the tax that is applicable to the total taxable income in step 3.

The tax table is:

Taxable income from lump sum benefits	**Rate of tax**
0 – R500 000	0%
R500 001 – R700 000	18% of the amount above R500 000
R700 001 – R1 050 000	R36 000 + 27% of the amount above R700 000
R1 050 001 and above	R130 500 + 36% of the amount above R1 050 000

The R250 000 falls in the first tax bracket as highlighted above. This means that there is no tax payable on that amount.

Step 5

Deduct the tax calculated in step 4 from the tax calculated in Step 2 to determine the tax payable on the current retirement benefit.

- Tax on all lump sums (Step 2) R310 500
- Less: Tax on previous lump sums (Step 4) (R0)
- Tax on current retirement benefit R310 500

The member will receive R1 189 500 of the total benefit of R1 500 000.

If the member in this example preserved his withdrawal benefit instead of taking it in 2010, that benefit could have doubled to R500 000 in 2019, assuming an annualised return of 8%. If that amount is then added to the benefit of R1 500 000, it comes to R2 000 000.

Step 1

Determine the total taxable income of all the lump sums received or accrued.

• Current retirement benefit	R2 000 000
• All withdrawal benefits on or after 1 March 2009	R0
• All retirement benefits on or after 1 October 2009	R0
• All retrenchment benefits on or after 1 March 2011	R0
• Less: excess fund contributions	(R200 000)
• Total taxable income	R1 800 000

Step 2

Apply the tax that is applicable to the total taxable income in step 1.

The tax table is:

Taxable income from lump sum benefits	**Rate of tax**
0 – R500 000	0%
R500 001 – R700 000	18% of the amount above R500 000
R700 001 – R1 050 000	R36 000 + 27% of the amount above R700 000
R1 050 001 and above	R130 500 + 36% of the amount above R1 050 000

- The R1 800 000 falls in the last tax bracket as highlighted above. The tax is calculated as follows:

  R130 500 + [36% of (R1 800 000 – R1 050 000)]
  = R130 500 + (36% of R750 000)
  = R130 500 + R270 000
  = R400 500

The member will then receive an amount of R1 599 500 of the total benefit of R2 000 000.

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