Government uses the tax system to encourage you to save for retirement and to discourage you from cashing in your savings before you retire, Jenny Gordon, Alexander Forbes’s head of retail legal advice, says. This is the second article in a series of reports on the Personal Finance/Alexander Forbes Ready Set Retire conferences that were held around South Africa in March.

You must take tax into consideration when you plan for retirement, but tax should not be the overriding consideration, Jenny Gordon says.

“Tax is a tool you use. Where possible, you take advantage of the tax opportunities,” she says.

The state provides a number of tax incentives to encourage saving for retirement and help you in retirement, Gordon says.

She says the retirement tax structure is based on three legs: exempt, exempt, taxed.

* Exempt. You can deduct – subject to certain limits – from your income contributions made to a tax-incentivised retirement product, such as an occupational retirement fund or a retirement annuity fund.

* Exempt. You do not pay capital gains tax (CGT), dividends withholding tax or income tax on the investment growth earned on savings in a retirement fund.

* Taxed. You pay tax, at your marginal rate of income tax, on your pension.
However, Gordon says, retirees still enjoy tax breaks, including:

* Your marginal tax rate in retirement is usually lower than the rate you were on while you were working. As a result, you will pay less tax on every rand you receive as a pension.

* There is no CGT, dividends withholding tax or income tax on the growth in a living annuity investment portfolio bought with retirement fund savings.

* At retirement, you can withdraw up to R500 000 tax-free from your retirement savings.

* You receive tax rebates in addition to the primary rebate (R12 726 in the 2014/15 tax year) that applies to all taxpayers. At age 65, you are entitled to the secondary rebate (R7 110), and at age 75 you receive the tertiary rebate (R2 367).

* Amounts in a tax-incentivised savings vehicle do not form part of your estate when estate duty or CGT is calculated. (This concession also applies before retirement.)

* Medical tax credit. Taxpayers over 65 are subject to the medical tax credits from this tax year. Medical tax credits operate like an additional rebate, Gordon says.

All medical scheme members are entitled to deduct medical scheme contributions up to R257 a month each for the main member and the first dependant and R172 a month for each additional dependant. In addition, people over 65 are entitled to a credit of 33.3 percent of medical contributions above a threshold, plus unrecovered expenditure.

Gordon says the tax incentives are there to encourage you to save for retirement. “The state wants to make sure you do not live on the state in retirement.”

However, the tax incentives are not unlimited. “The state
wants us to have sufficient income in retirement – not a lavish retirement.”

As a result of the limits, your retirement-saving strategy must include products apart from retirement funds, Gordon says.

Most people believe that contributions to an occupational retirement fund will provide sufficient savings for retirement, she says.

“While a pension fund provided by your employer is an excellent springboard, it is unlikely to give you sufficient money for a financially secure retirement.”

People often aren’t concerned about saving, or saving additional amounts outside of a retirement fund, until they are older. By then, you might be using all the tax incentives for saving in a retirement fund. To reach your savings goal, you will have to consider products that don’t provide tax deductions on the contributions but offer lower rates of tax on the income you receive in retirement, Gordon says.

Products are affected in different ways by income tax, CGT, dividends tax and estate duty. You need to find out how tax will affect the net return on the investment.

The tax could be payable in your hands when you receive a benefit, as is the case with unit trust funds, or be tax-free in your hands, as with an endowment policy where the life assurance company pays the tax on your behalf.

Gordon says that government’s proposed tax-incentivised savings product will be a good option, because none of the returns will be taxed. However, there will be a limit on the contributions: R30 000 a year or R500 000 over your lifetime.

“For most of us, tax is a difficult concept to get our heads around. We are not always on top of the latest tax
implications and how these may affect our financial plans.”

As a result, it is important regularly to obtain financial advice that takes into account the latest tax laws and regulations, she says.

**FIVE BASIC RULES**

There are five basic rules you should follow when it comes to tax and planning for retirement, Jenny Gordon says. These are:

1. The desire to minimise tax must not be the overriding factor. Tax concessions are designed to encourage you to save for retirement and should never take precedence over prudent investment planning.

2. Base your plans on existing tax legislation, not on speculation about possible changes.

3. Keep saving, regardless of changes to the tax laws.

4. Take remedial action if changes to the tax system will affect your savings goal.

5. Structuring your finances to derive the best tax advantages in retirement must start long before you retire.

**CASHING IN ALONG THE WAY WILL COST YOU**

The state’s main weapon to discourage you from spending your retirement savings before you retire is the taxation of lump sums withdrawn from retirement savings, Jenny Gordon says.

If you resign and transfer your retirement savings to another retirement fund or leave them in the fund provided by your former employer, they will not be taxed.

But if you withdraw your retirement savings, you will pay tax as follows: no tax on the first R25 000 you withdraw; tax at a rate of 18 percent on any amount between R25 001 and R660 000; tax of 27 percent on amounts between R660 001 and R990 000;
and tax of 36 percent on any amount from R990 001. These tax rates are onerous, Gordon says, particularly when compared with the taxation of lump sums at retirement, on retrenchment or death. In those cases, you can take up to R500 000 tax-free. Thereafter, the withdrawal between R500 001 and R700 000 is taxed at 18 percent; the withdrawal between R700 001 and R1 05 million is taxed at 27 percent; and any amount above R1.05 million at 36 percent.

Lump-sum withdrawals from a pension fund at retirement are limited to one-third of your savings (provident fund members can take more, although this will change). Thus the state wants to ensure that you use most of your savings to buy a sustainable pension.

Withdrawing your savings before retirement can be particularly damaging if you take as much as you can, Gordon says.

For example, if you withdraw R1.05 million before retirement, you will pay tax of R225 000, but if you withdraw the same amount at retirement, you will pay tax of R130 500, which is R94 500 less.

Gordon says you must follow three rules to derive the maximum benefit from your retirement savings: preserve, preserve, preserve.

She says government will introduce measures to encourage you to preserve your savings before retirement. If you resign, the default option is to take your retirement savings as a lump sum; you have to make a deliberate decision to preserve your savings. Government will change the default option to preservation. If you want the cash, you will have to make a deliberate decision to take it.

**SIMPLER SYSTEM COMING**

The way retirement savings are taxed will change next year to make the tax structure less complicated and stop perceived
 abuses, Jenny Gordon says.

Different types of retirement funds are taxed differently, to the disadvantage of some fund members, particularly with regard to the percentage of contributions made from pensionable income that can be claimed as a tax deduction. But this will change when a simpler tax regime for retirement funds is introduced on March 1, 2015. The features of this regime include:

* A tax deduction of up to 27.5 percent on all contributions made from your taxable income to your retirement savings. The deduction will be capped at R350 000 a year, so you will not be able to claim a deduction against taxable earnings that exceed R1 272 727.

* Employer contributions will be taxed as a fringe benefit.

* The deduction of up to 27.5 percent will include the cost of any risk life assurance attached to your retirement fund, as well as administration costs.

* If you contribute more than you can deduct in a year, you can carry over the amount and deduct it in a year when you contribute less than the maximum contribution, or you can increase the tax-free amount of a cash withdrawal, or you can offset the amount against the taxable portion of your pension.

As a result of these changes, some fund members will be able to claim a larger tax deduction than they can now, Gordon says.