Budget 2014 – Lump sum tax break for people who retire

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ONE of the biggest bits of good news in this year's budget is for those who are facing retirement. Most pensioners take a lump sum of one-third of their accumulated capital when they retire. The tax-free threshold for these lump sums has been increased from R315000 to R500000. Special national treasury adviser David McCarthy says it is inequitable that the lower-paid, who did not benefit from a tax deduction as they weren't paying income tax, should have to pay tax on their lump sums.

The wealthier will benefit as well, as the top rate of 36% now kicks in at R1,05m, up from R945000 in the past financial year.

Government has also reduced tax on lump sums taken before retirement, with tax kicking in at R25000, up from R22500.

McCarthy says a priority for government will be to bring 6m employed workers who have no access to a company scheme at present into the retirement fund net.

"Unlike the UK auto-enrolment system, employees will not have the chance to opt out. It will not be a complex scheme [but will have] clearly prescribed minimum contributions."

There are negotiations at Nedlac between government, labour and business to find the way forward.

Finance minister Pravin Gordhan announced in the budget speech that there has been an agreement between government and the Association for Savings & Investment SA, the trade body for asset managers and life offices, to reduce the level of charges for retirement savings products.

Momentum Employee Benefits project leader Rowan Burger says the pensions industry has been accused of high costs, but these costs can be reduced considerably if compulsory preservation and annuitisation (conversion of lump sums to pensions) are introduced.

Government will set out its road map for a pension reform in a document to be released next week. T-Day, the day on which pension and provident fund tax treatment will be harmonised, is set for March 1 2015.Government will also introduce an annual cap of R350000 on tax deductions from pension funds and/or retirement annuities.

But the date for P-Day, on which compulsory preservation is to be introduced, has not been announced.

Compulsion is controversial as many vulnerable workers genuinely need to have access to their pension money. McCarthy says the new legislation will acknowledge this. But it will no longer be everyone's right to cash in their pensions early.

Government is definitely going ahead with its tax-preferred savings, modelled on the UK's Investment Savings Accounts (ISA). Each person will be allowed to invest up to R30000/year into the vehicle (so far unnamed). The money is then free from all tax on interest and dividends, and all capital gains tax. Says Burger: "People will able to draw on this capital, and it should provide a source of emergency funding in place of pension capital." Burger says the vehicle should appeal to both conservative investors, who prefer to invest in bank deposits, and the more adventurous, as unit trusts can be housed in them as well.

"We will be competing with government as it is hoping to see its retail savings bonds used actively. I hope it will compete fairly and stop claiming that its products are 'risk free'. Ask the Greeks if government bonds are risk free. And the administration costs of these bonds are carried by the general taxpayer, not by the owners of the bonds." Burger recommends a multiasset or balanced fund for most investors.

One little-noticed item in the Budget Review is the change to the treatment of foreign reinsurance. This is aimed at Old Mutual International and its life accounts, which wrap up a portfolio of offshore investment options. Under OMI's scheme, returns earned on the investments held by the reinsurer are paid as reinsurance benefits.

These are taxed in SA, as reinsurance premiums are wholly disregarded in determining tax liability. Gordhan proposes that net returns from foreign reinsurance should be included in the insurer's tax calculation. OMI will need to adjust its business model and this may affect its returns.

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