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EMPLOYEE BENEFITS SPECIALISTS

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Taxation of Lump Sum Withdrawal Benefits

With effect from 1 March 2009, the Revenue Laws Amendment Act, 2008, introduced a new method for the taxation of lump sum withdrawal benefits.

Prior to 1 March 2009, lump sum withdrawal benefits from retirement funds were taxed at the member's average rate of tax with the first R1 800 in each tax year free of tax. Lump sum withdrawal benefits will now be taxed according to a prescribed withdrawal benefit tax table. This tax table, as published in the Draft Taxation Laws Amendment Bill, 2009, is shown below:

TAXABLE INCOME FROM LUMP SUM WITHDRAWAL BENEFITS	RATE OF TAX
0 – R22 500	0%
R22 501 – R600 000	18% of the amount above R22 500
R600 001 – R900 000	R103 950 plus 27% of the amount above R600 000
R900 001 and above	R184 950 plus 36% of the amount above R900 000

With effect from 1 March 2009, **all** lump sum benefits received from a retirement fund will be taxed on a cumulative basis. The significant impact of this is that when the member eventually retires, the **total** value of the lump sum withdrawal benefits previously received by the member will now be taken into account when calculating the tax-free amount payable on the member's retirement. In terms of the proposals contained in the Draft Taxation Laws Amendment Bill, 2009, tax on retirement fund lump sum benefits will, with effect from 1 March 2009, also be calculated, taking into account the accumulation of **all** previous lump sums from retirement funds.

The effect of the new method for taxation of lump sum withdrawal benefits is best illustrated by way of a few examples:

Example 1: If a member withdraws from a fund after 1 March 2009 and receives a lump sum withdrawal benefit of R200 000, the first R22 500 will be taxed at 0% and the balance will be taxed at 18%, resulting in total tax payable of R31 950.

Example 2: If the same member withdraws from another fund a couple of years later and receives a lump sum withdrawal benefit of R500 000, the tax will be calculated by adding the previously accrued lump sum of R200 000 and the current R500 000 lump sum and then calculating the tax on the combined amount of R700 000. The tax on the R700 000 will be R103 950 plus 27% on the amount above R600 000, which amounts to R130 950. The amount of tax on the previous lump sums must also be calculated, using the same table. The tax on the previous lump sum of R200 000 will be calculated at

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18% on the amount above R22 500, which amounts to R31 950. To calculate the tax payable on the R500 000, the tax calculated in respect of the previously accrued lump sums is deducted from the tax on the total lump sum. Thus, tax payable is R130 950 less R31 950 = R99 000.

Example 3: If the same member retires a couple of years later with an amount of R900 000 and elects to take R300 000 as a cash lump sum, his taxable amount will be calculated by using the following retirement lump sum tax table:

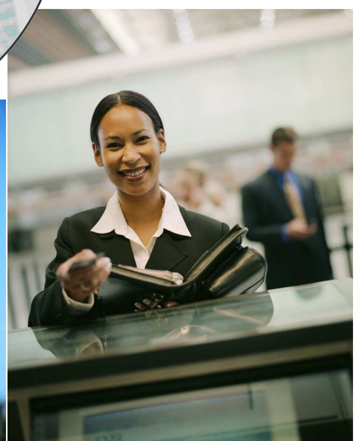
TAXABLE INCOME FROM LUMP SUM RETIREMENT BENEFITS	RATE OF TAX
0 – R300 000	0%
R300 001 – R600 000	18% of amount above 300 000
R600 001 – R900 000	R54 000 plus 27% of the amount above R600 000
R900 001 and above	R135 000 plus 36% of the amount above R900 000

To calculate the tax payable on the lump sum retirement benefit, all the previously accrued lump sum benefits must be accumulated, that is, the R700 000 (Example 1, R200 000 and Example 2, R500 000) lump sum withdrawal benefits taken previously and the R300 000 lump sum retirement benefit taken now.

Tax on the R1 m will be calculated as follows:
R135 000 plus 36% on R100 000 = R171 000. The tax on the previously accrued lump sums must now be calculated according to the above retirement tax table, that is, 27% on R100 000 plus R54 000 = R81 000. The tax payable on the R300 000 lump sum will be R171 000, minus R81 000 = R90 000.

Example 4: If a member has not elected to take a lump sum withdrawal benefit prior to retirement and on retirement receives a lump sum benefit equal to R1 000 000, tax on that will be R135 000 plus 36% on R100 000 = R171 000. If we compare this with the total tax that the member in Example 3 paid (that is, R31 950 + R99 000 + R90 000 = R220 950) we see that the early withdrawals cost the member in Example 3 an additional amount of R49 950 in tax.

It is therefore of the utmost importance that members are informed of the far-reaching financial consequences prior to them electing to take their withdrawal lump sum benefits in cash. Members must be encouraged to rather preserve their withdrawal lump sum benefits in a preservation fund, a retirement annuity fund or another retirement fund, as it will not attract tax and the full tax-free amount of R300 000 will be available on retirement.



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