Retirement advice

Excess contributions to SARS-approved retirement funds

What you may need to consider when planning for retirement

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What is excess contribution to a retirement fund?

It is a contribution to a SARS-approved retirement fund (pension fund, provident fund or retirement annuity fund) that exceeds the annual tax-deductible contribution limit in any particular year of assessment. The limit for each year of assessment is currently 27,5% of remuneration or taxable income, capped at R350 000. In addition to the limit, annuities and lump sum withdrawals can be set off against excess contributions until excess contributions are fully utilised ie, they can be withdrawn tax-free.

Purpose of this document

To provide individuals with an overview of excess contributions to retirement funds and how this will affect them.

In this guide

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Tax advantages and disadvantages of excess contributions

Relevant tax legislation	Advantages*	Disadvantages
Section 11F of the Income Tax Act, 58 of 1972	**Excess contributions are deductible against taxable income (if applicable).** This will be the case in subsequent tax years up to the limit each year until they have been used up fully. This limit is currently 27,5% of remuneration or taxable income, capped at R350 000.	None.
Section 10C of the Income Tax Act	**Excess contributions can be set off against annuities until fully used up.** This will be applicable only once you have retired from the fund and an annuity (living or life) has been purchased. Please note: Income is received net of PAYE from the fund, but such tax is refundable in full on submission of your annual tax return.	None.
Paragraphs 5 and 6 of the Second Schedule to the Income Tax Act	**Lump sums can be set off against excess contributions.** Excess contributions not previously deducted or set off for tax purposes (as referred to above) can be **added to the tax-free portion** of (i) a cash lump sum withdrawal according to the withdrawal tax table; or (ii) a cash lump sum at retirement or death according to the retirement tax table.	None.
Section 3(3)(e) of the Estate Duty Act , 45 of 1955	**If receiving annuities after death of a member, excess contributions are excluded for estate duty.** To the extent that a nominated beneficiary elects to receive **annuities** on the death of the member the remaining excess contributions are **excluded for estate duty** purposes. Please note: Excess contributions made by the deceased member are not transferable to the nominated beneficiary.	**If receiving a lump sum after the death of a member, excess contributions are included for estate duty.** If a nominated beneficiary chooses to receive a **lump sum** of the deceased member, any remaining excess contributions to the extent of such lump sum is **included for estate duty** purposes.

* Available excess contributions decrease with each tax deduction or set-off, in line with above. Once they have been fully utilised, the above is no longer applicable.

Comparison of considerations for discretionary funds, retirement funds, and South African inter vivos trusts

	Discretionary funds	Retirement funds	South African inter vivos trusts
Transfer	✓ **No tax payable on the initial investment amount** (lump sum or recurring). ✗ No tax deduction available when investing in your name (as an individual) in discretionary funds.	✓ **Contributions are tax-deductible** up to the limit and excess contributions can be carried forward to deduct in subsequent years.	✗ **Funding by way of a donation,** which is subject to donations tax and ongoing attribution rules. ✗ **Funding by way of a loan**. Interest should be charged which is subject to income tax – if not, anti-avoidance provisions apply to tax the interest forgone.
Returns	✗ Returns on retirement fund assets are subject to tax according to **individual tax rates**.	✓ Returns on retirement fund assets **are tax-free** in the fund.	✗ Returns on trust assets are **subject to tax according to trust tax rates or** in terms of **attribution or distribution provisions**.
Access	✓ Access to retirement savings **depends on rules** of investment selected.	✗ **Limited or no access** to retirement savings before retirement. Please note: When the 'two-pot retirement system' is implemented, access to and preservation of retirement funds will be more flexible. ✓ **Lump sums and annuities** are **taxable only when excess contributions** have been **fully utilised**.	✓ Distributions are **at the trustees' discretion**, with the wishes of the settlor and needs of the beneficiaries considered. ✗ **Distributions of income and/or capital gains are taxable** in the the beneficiaries' hands if not previously taxed in the trust.

	Discretionary funds	Retirement funds	South African inter vivos trusts
Ease of estate administration	✗ They are subject to **estate administration process**, unless using an endowment.	✓ **Beneficiary nominations are possible**; however, these will be subject to section 37C of the Pension Funds Act, 24 of 1956, except in the case of a living annuity.	✓ **Trust beneficiaries** are set out in the trust deed (this must be read together with the letter of wishes) and can be amended. Intergenerational wealth transfer is ensured.
Diversification	✓ Asset allocation is **dependent on rules** of investment selected.	✗ **Regulation 28** of the Pensions Funds Act **restricts the asset allocation** and extent to which international exposure can be obtained in retirement funds, except living annuities.	✓ There is **no restriction** on asset allocation, however, direct international exposure cannot be obtained.
Protection in case of divorce or sequestration	✗ **There is no protection.**	✗ Spouse can **access** capital in case of **divorce**, except in case of a living or life annuity. ✓ **Funds are protected from creditors**, except in the case of SARS and an employer in limited circumstances.	✓ Spouse cannot **access** trust capital in case of **divorce**, except if trust is regarded as an alter ego or in the case of concealment of assets. ✓ **Trust is protected from creditors**, except relating to the loan or if trust is regarded as an alter ego.
Estate duty	✗ **Estate duty is included** for estate duty purposes.	✓ **Estate duty** is payable in the deceased estate of the member, **if the nominated beneficiary takes a lump sum**.	✗ **Loan** owing at death (including accumulated interest) is included in property for **estate duty** purposes.
Executor's fees	✗ **Executor's fees are payable** on death, except in the case of an endowment.	✓ **No executor's fees** are payable on retirement fund assets.	✓ **Executor's fees are only** payable **on loan** owing at death.

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	Discretionary funds	Retirement funds	South African inter vivos trusts
Emigration	✓ **Access to income and capital** according to exchange control regulations.	**Preretirement (from the fund):** ✓ **Pension or provident funds and preservation funds** (where no previous withdrawal was made): Capital can be withdrawn in full. ✓ **Retirement annuities and preservation funds** (where a previous withdrawal was made): Capital can be withdrawn in full, but proof is required by SARS that you have been a non-resident for a three-year uninterrupted period. Please note: When the 'two-pot retirement system' is implemented, the vested pot and savings pot will be accessible in full immediately. The retirement pot will be accessible only at retirement provided the three-year requirement is met. **Post-retirement (from the fund):** ✗ **Remainder** of capital in living or life annuities cannot be withdrawn. ✓ **Annuities can be remitted abroad.**	✓ Access to income and capital is **not affected** by emigration.

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An example of how excess contributions work

Mr X, a South African tax resident, contributed R20 million at the age of 55 to a new retirement annuity (RA), which is his only retirement fund.

Assumptions:

Marginal tax rate before retirement	Age that RA was retired from	Lump sum taken at retirement	Amount used to purchase a living annuity (LA) at retirement	RA or LA growth per annum	LA allows annuity rates of: 2,5–17,5%			Age at death
					Rates elected at various ages:			
					Age 62	Age 70	Age 75	
45%	End of 61 years	1/3rd	2/3rd	5%	7%	10%	15%	82 years

Utilisation of excess contributions according to SARS' record:

	Applicable sections in the Income Tax Act	Tax consequences	Age when set off occurs	Total utilised
Annual deductions (27,5% of remuneration or taxable income, capped at R350 000)	Section 11F	Reduced taxable income.	55, 56, 57, 58, 59, 60, 61	R2 450 000
Set-off against lumpsum at retirement	Paragraph 5 of Second Schedule	No tax payable.	End of 61 years	R9 380 669
Set-off against annuities	Section 10C	No tax paid until excess contributions have been fully utilised (fund pays tax but SARS refunds on assessment).	62, 63, 64, 65, 66, 67, 68 (age at which excess contributions are fully utilised)	R8 169 331
Set-off of lumpsum at death (assuming beneficiary took the full amount as a lumpsum)	Paragraph 5 of Second Schedule	N/A	N/A	R0*
Total excess contributions				**R20 000 000**

* Please note: Death lump sum of R6 202 651 cannot be set off against excess contributions since these were fully used in previous years. Accordingly, tax should be payable on this amount according to the retirement/death lump sum benefit table. The amount would, however, not be included as property for estate duty purposes.

If instead Mr X passed away at age 62:

	Applicable sections in the Income Tax Act	Tax consequences	Age when set off occurs	Total utilised
Annual deductions (27,5% of remuneration or taxable income, capped at R350 000)	Section 11F	Reduced taxable income	55, 56, 57, 58, 59, 60, 61	R2 450 000
Set-off against lump sum at retirement	Paragraph 5 of Second Schedule	No tax payable	End of 61 years	R9 380 669
Set-off against annuities	Section 10C	No tax paid (fund pays tax but SARS refunds on assessment).	62 years	R1 313 294
Set-off of lump sum at death (assuming beneficiary took the full amount as a lump sum)	Paragraph 5 of Second Schedule	No tax payable on a portion (R6 856 037).	End of 62 years	R6 856 037*
Total excess contributions				**R20 000 000**

* Please note: Although the death lump sum is R18 386 112, only an amount equal to the remaining excess contributions can be set off (ie R6 856 037). Tax should, therefore, be payable on the difference according to the retirement/death lump sum benefit table. The amount of R6 856 037 would further be included as property for estate duty purposes. (if the death benefit was used to purchase annuities instead, estate duty would not apply.)

Should Mr. X have emigrated before retirement at age 61, he would be able to continue utilising section 11F to the extent that he has South Africa-sourced taxable income. He would also, at that time, be able to access the full capital in the RA (provided the three-year requirement is met). However, had he emigrated post-retirement, the capital in the LA would not be accessible, although he would be able to continue receiving annuities abroad.

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A summary of what to keep in mind when considering making excess contributions

1 Excess contributions are **tax-advantageous** from an income and lump sum perspective. Although estate duty may be payable in respect of the excess contributions remaining at death (to the extent that the beneficiary elected to receive a lump sum at death), if you retain the funds in your personal name, estate duty would have applied to the full amount in any event.

2 If you intend to retire from a retirement fund and need retirement income, you could **consider making excess contributions** to the retirement fund and transferring such amount immediately to a living (or life) annuity to ensure tax efficiency (which is limited to the extent of excess contributions).

3 Contributing substantial amounts to a retirement fund **should not be done on the sole basis to save tax**. It is important to consider the overall advantages and disadvantages to make an informed decision.

4 **Your wealth adviser will consider your needs**, goals, and financial aspirations and provide you with appropriate, tailored advice. For retirement planning purposes, making excess contributions is an option that you can consider talking to your wealth adviser about.

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