

ASAP

Legal and Technical Update

Retirement fund contributions

Disallowed contributions

Since the introduction of the amended section 11F (retirement fund contribution deduction) and section 10C (exemption iro compulsory annuity income insofar disallowed contributions are available), many clients have made ad hoc contributions into retirement funds on an annual basis (specifically retirement annuity funds) to enjoy the exemption provided for in section 10C iro compulsory annuity income earned during that same year of assessment. The following example will illustrate this:

Mr RE Tire retired a couple of years ago and receives R400 000 per annum from a living annuity. He still works on contract. During this year of assessment he earned R450 000 from his contract work. He invested it all into a retirement annuity. Assuming this is his only income and he has no other deductions, the retirement fund contribution deduction that he will be entitled to is equal the lesser of:

- R350 000, or
- 27.5% of R850 000 = R233 750, or
- R850 000.

Therefore his deduction is limited to R233 750 which results in a disallowed contribution of:

- R450 000 – R233 750 = R216 250.

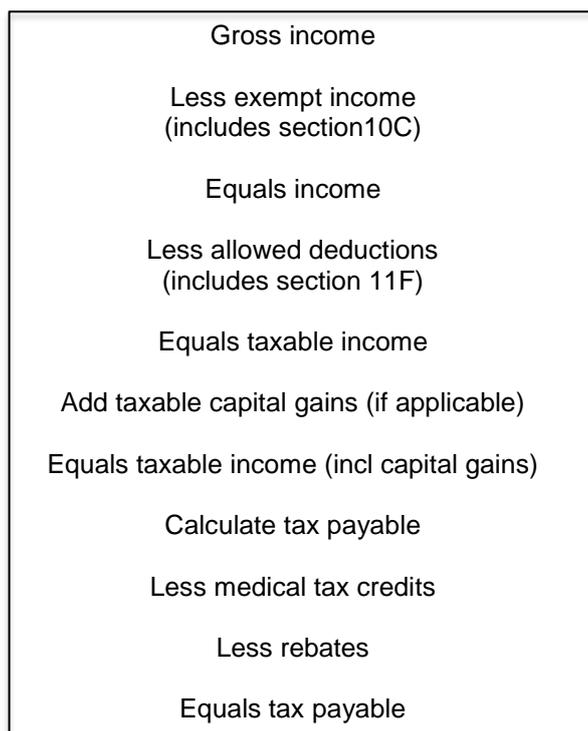
If the section 10C exemption would apply, his taxable income will be determined as follows:

Gross income	R850 000
Less exempt income	R216 250
Less retirement fund contributions	R233 750
Taxable income	R400 000

Clarification

In 2018 SARS provided certainty in respect of disallowed contributions and whether a contribution made in a tax year can also be seen as a disallowed contribution in that same year of assessment. The answer has come back as NO.

The interpretation of the Act supports this answer and it lies in the sequence of the tax calculation. The general outline of an income tax calculation is as follows:



This is a strict order that is prescribed by the Act.

Step 1:

When determining gross income, one would also consider all lump sums received from retirement funds during that year of assessment.

In terms of paragraphs 2, 5 and 6 of the Second Schedule, the lump sums will be reduced by all contributions made by the taxpayer that:

- did not rank as a deduction under section 11F, or
- which has not been exempted under section 10C, and
- which has not been allowed as a deduction against any previous lump sums.

Step 2:

Then the exemptions will be determined in terms of section 10.

Section 10C allows for an exemption against compulsory annuity income earned. It will be equal to retirement fund contributions made by the taxpayer that did not rank as a deduction under section 11F and that was not previously utilized under section 10C or under paragraphs 5 and 6 of the Second Schedule.

Step 3:

Determine all deductions against income which will include the contributions made to retirement funds within the limits prescribed by section 11F. This clearly shows that the disallowed contribution can only be determined in step 3 which results in the interpretation that a contribution cannot be seen as a 'disallowed contribution' in the same year of assessment that it is made in.

Therefore the outcome of this interpretation on our example is as follows:

Mr RE Tire retired a couple of years ago and receives R400 000 per annum from a living annuity. He still works on contract. During this year of assessment he earned R450 000 from his contract work.

He invested it all into a retirement annuity. Assuming this is his only income and he has no other deductions, the retirement fund contribution deduction that he will be entitled to is equal to the lesser of:

- R350 000, or
- 27.5% of R850 000 = R233 750, or
- R850 000.

When we apply the steps as explained, the tax calculation and its impact on the section 10C exemption will be as follows:

Gross income	R850 000
Less exempt income (no disallowed contributions from previous year of assessment)	NIL
Less retirement fund contribution	R233 750
Taxable income	R616 250

The disallowed contribution is now calculated as follows:

Contributions to RA	R450 000
Less allowed deduction	R233 750
Disallowed contribution	R216 250,

which will be carried over to the following year of assessment.

In that following year of assessment it will be applied as follows:

- Firstly as a deduction against any retirement fund lump sum to determine the taxable portion,
- Secondly, any remaining disallowed contribution to be applied as a section 10C exemption if compulsory annuity income is earned in that year, and
- Thirdly, any remaining amount to be deducted under section 11F and if there is an amount that does not qualify due to it being in excess of the maximum deductible amount, it will be rolled over to the following year of assessment.

The impact in the following year is highlighted by the continuance of Mr RE Tire's situation in the 2020 tax year:

During the following year of assessment Mr RE Tire will earn R420 000 from his living annuity and he earns R500 000 from his contract work.

He invests all the income from his contract work into a retirement annuity.

Assuming this is his only income and he has no other deductions, the retirement fund contribution deduction that he will be entitled to is equal to the lesser of:

- R350 000
- 27.5% of R920 000 = R253 000 or
- R920 000.

When we apply the steps as explained, the tax calculation and its impact on the section 10C exemption will be as follows (the disallowed contributions of the previous year will now be taken into account):
Gross income:

Living annuity income	R420 000
Contract work income	R500 000
	R920 000
Less S10 C exempt income (the disallowed contributions from previous year)	R216 250
Less retirement fund contr	R253 000
Taxable income	R450 750

The disallowed contribution is now calculated as follows:

Contributions to RA	R500 000
Less allowed deduction	R253 000
Disallowed contribution	R247 000,

which will be carried over to the following year of assessment.

Estate Duty Implications

Since 1 January 2016, all disallowed contributions made to retirement funds as on the date of death will be included as an asset in the estate of the deceased.

This is in terms of clause 3(2)(bA). The section reads as follows:

“(bA) so much of the amount of any contribution made by the deceased in consequence of membership or past membership of any pension fund, provident fund, or retirement annuity fund, as was not allowed as a deduction in terms of section 11 (k) or (n) of the Income Tax Act, 1962 (Act No. 58 of 1962), or paragraph 2 of the Second Schedule to that Act or, as was not exempt in terms of section 10C of that Act in determining the taxable income as defined in section 1 of that Act, of the deceased;”

Therefore, where a taxpayer dies during a year of assessment, their personal income tax will first be finalised for that year of assessment before the final disallowed contributions can be determined. That final disallowed contribution that could not be deducted or applied in terms of section 10C or 11F or the Second Schedule will be included in the deceased’s estate as an asset.