momentum

financial planning

Lower your marginal tax rate by contributing to a retirement annuity (RA)

The Income Tax Act permits taxpayers to deduct the contributions made to retirement funds, including retirement annuity (RA) contributions, for income tax purposes within certain limits.

The maximum tax-deductible contributions to retirement funds (including pension, provident and RA funds) for all taxpayers are equal to 27.5% of the greater of:

- 'Remuneration' as defined in the Fourth Schedule to the Income Tax Act (excluding retirement fund lump sums and retrenchment benefits), or
- Taxable income (including passive income but before taking the deduction for donations into account and excluding taxable capital gains, retirement fund lump sums and retrenchment benefits),
- capped at a maximum of R350 000 per annum.

Example

John and Carin each earn R220 000 remuneration per annum.

John contributes R33 000 per annum to his RA. The maximum tax deductible contribution that John is entitled to per annum is R60 500 (27.5 % x R220 000). Therefore, the total contribution of R33 000 is tax deductible.

Carin does not contribute to an RA or any other retirement fund.

Carin pays tax on a taxable income of R220 000 while John, with the same remuneration, has a taxable income (after the deduction of the RA contribution) of R187 000.

	Carin	John
Gross income	R220 000	R220 000
RA contribution	R0	R33 000
Taxable income	R220 000	R187 000
Tax per scale (2016/2017)	R42 160	R33 660
Less rebate	-R13 500	-R13 500
Tax payable	R28 660	R20 160

Thus, by making a tax-deductible RA contribution, John pays R8 500 less tax than Carin. Carin's marginal tax rate is 26% and John's marginal tax rate is 18%.

If we assume a growth rate of 8% per annum, John would have built up a retirement fund worth R35 640 for a net outlay of only R24 500 (R33 000 less R8 500 tax) by the end of that year.

Carin would still have nothing!