



An international comparison of the tax treatment of South African retirement funds

TE Tshivhenga

 **orcid.org/0009-0001-5477-0188**

Mini-dissertation accepted in partial fulfilment of the requirements for the degree **Master of Commerce in Taxation** at the North-West University

Supervisor: Mrs CE Meiring

Graduation: May/June 2026

DEDICATION

I dedicate this dissertation to the memory of my beloved grandmother, Mafanedza Munyadziwa Musitha. Her love, care and nurturing presence brought warmth and stability that I will always carry with me. May this achievement stand as a tribute to her lasting memory and the deep love I hold for her. May her soul rest in eternal peace.

This master's dissertation is also dedicated to my mother, Sophie Tshivhenga, who holds an irreplaceable and cherished place in my heart. Her strength, resilience, and determination in overcoming countless challenges as a single parent while raising me and my brothers are nothing short of extraordinary. She has been a constant source of unwavering love, boundless support, and selfless sacrifices, all of which have shaped the person I am today. Her encouragement has been my guiding light, inspiring my thirst for knowledge and the pursuit of excellence. Without her countless sacrifices and steadfast faith in my abilities, this milestone would have remained a distant dream. I will forever be grateful for her unconditional love, which continues to motivate me to strive for greatness and make her proud. This achievement is as much hers as it is mine.

ACKNOWLEDGEMENTS

First and foremost, I would like to thank the Almighty God for giving me the strength and knowledge to pursue this degree and guiding me through this journey. It all rounds back to, Vhakorinta ya Il 13:14 “Tshilidzi tsha Mudzimu washu Yeso Kristo na lufuno lwa Mudzimu na u konana na Muya-mukhethwa zwiri linde, zwiri vhulunge u swika Yeso Kristo a tshi do vhuya, Amen”

I would like to acknowledge and thank the following individuals for their support and guidance:

- My mother, Sophie Tshivhenga for supporting me throughout my academic journey, for being my cheer leader and her prayers.
- My brothers, Phathutshedzo Blessing, Phumudzo Tshivhenga and my sister-in-law Livhuwani Tshivhenga for your support throughout my studies.
- My supervisor, Corrie Meiring for the invaluable guidance provided, insightful comments that were instrumental in the completion of this dissertation and the unwavering support.
- My high school commerce teachers, Tshilwambwana LM, Mulaudzi TF and Rasikhanya MJ for instilling the love of commercial subjects in me which subsequently led to me obtaining 100% and ultimately qualifying as a Chartered Accountant.
- Khangwelo Bethuel Ramushweu (LLM) for always motivating me in moments I felt like giving up, your guidance relating to research and dissertation writing and for being a positive role model.
- Vincent Didiba for your encouragement and motivation that inspired me to pursue my studies with determination, and your willingness to lend a listening ear during my moments of frustration made the challenges more bearable.
- My friends, Kutlwano Samuels CA(SA), Ligau Khumbudzo, Motsoko Sebotse, Mchavi Vonisani CA(SA), Shadi Legodi and Bongane Monyele for all your support and encouragement.

In addition to the above acknowledgments, there is often a universe of people deserving mention. While it would require countless pages to individually recognize each person's influence, please know that your support has been deeply appreciated. To each friend, family member, and colleague whose support and encouragement have been invaluable on this journey, I extend my deepest gratitude. Indeed, it takes a village to raise a child. Thank you all for being part of my village, for shaping me, and for sharing in this milestone.

ABSTRACT

The South African retirement system has undergone multiple changes over the past few years and in September 2024, South Africa implemented the two-pot retirement system. This meant that individuals under the retirement age will now be able to access a portion of their retirement savings throughout their working years for emergencies and will no longer only be able to access their retirement savings by simply resigning. This was the most significant change in the retirement system that provided individuals with flexibility which was necessitated by the need to immediate access to cash. Previously this led to individuals resigning from their employment in order to access their retirement savings which ended up being depleted before their actual retirement if they do not reinvest some of the funds or contribute to alternative retirement instruments or funds.

The study examines the research problem relating to the lack of knowledge by ordinary residents of the income tax implications of retirement funds either at retirement, resignation, death, or early access to the retirement funds. The aim of the study was to investigate the income tax implications of funds received at early access, retirement, resignation and benchmark these against the tax treatments of Australia, Canada, UK and the USA. The study provides a comprehensive evaluation and analysis by examining tax implications at critical points of the retirement fund lifecycle across all selected countries.

The study employed a qualitative approach that focused on a comprehensive literature review. Sources reviewed as part of the literature review included tax acts, publications on international retirement systems and other sources. The study revealed that various governments have a compulsory government backed retirement fund that is government sponsored and funded by employee's contributions and other voluntary plans to supplement their retirement savings.

The study also found that the South African retirement system is comparable to the selected countries due to the fact that they follow similar tax approaches on certain aspects of retirement funds. Based on the analysis and comparison, recommendations were proposed on how the South African retirement system can be made fairer and more effective and suggestions on further areas of study on this topic have been made.

The findings of this study will provide insights to public by clarifying the tax implications associated with retirement funds to allow them to make an informed decision regarding their retirement planning and possible move to other countries. The recommendations will provide policy makers with insight on how the South African retirement system can be amended to align it more closely to the system of the selected developed countries which ultimately benefits the individuals.

Keywords: retirement funds; tax treatment; two-pot; resignation; retirement; early access

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LIST OF ABBREVIATIONS

ATO	Australian Taxation Office (Australia)
CPP	Canada Pension Plan (Canada)
EET	Exempt exempt-taxed
GEPF	Government Employees Pension Fund (South Africa)
IRA	Individual Retirement Account (USA)
IRS	Internal Revenue Service (USA)
ITA	Income Tax Act 58 of 1962 (South Africa)
NEDLAC	National Economic Development and Labour Council (South Africa)
OCED	Organisation for Economic Co-operation and Development
QPP	Quebec Pension Plan (Canada)
RPP	Registered Pension Plan (Canada)
RRIF	Registered Retirement Income Fund (Canada)
RRSP	Registered Retirement Savings Plan (Canada)
SARS	South African Revenue Service (South Africa)
SSA	Social Security Administration (USA)
TLAA	Taxation Laws Amendment Act (South Africa)
UK	United Kingdom
USA	United States of America

CHAPTER 1: INTRODUCTION

1.1 Background to the research area

Over the past 20 years, the South African retirement funds regime has undergone major reforms leading to numerous amendments to the Pension Funds Act 24 of 1956 (National Treasury, 2004). On 22 June 1994, the new post democracy government announced the establishment of the Commission of the Inquiry into Taxation which was commonly known as the Katz Commission (Manuel, 2002). The main mandate of the Katz Commission was to investigate all aspects of the tax regime inherited from the pre democracy government (Manuel, 2002). The terms of reference included personal income tax, which specifically focused on tax rates, income brackets and thresholds, amongst others, which included the tax on retirement funds (Manuel, 2002). In the pre democracy period, retirement funds were taxed using the exempt exempt-taxed (EET) system wherein contributions towards retirement were tax-exempt, investment returns on those contributions were also exempted from taxation as they accumulate, however, taxes were imposed on retirement benefits on retirement or withdrawal (JSCOF, 1999). The Katz Commission found that the EET system compromised the integrity of the tax system which led to significant losses of tax revenue and created an opportunity for tax evasion and exploitation (JSCOF, 1999).

The Katz Commission made a series of recommendations on the retirement system including, amongst others, the tax on retirement fund benefits at a progressive rate which entailed taxing retirement benefits at a sliding scale, consistent tax treatment of public and private sector funds, the introduction of deductions from the taxable amount and the revision of the legislation pertaining to the pension and provident funds (JSCOF, 1999).

In the 1996 Budget Speech, the then Minister of Finance, Mr Chris Liebenberg, indicated that the government accepts specific principles as recommended by the Katz Commission to be included in the new system of retirement fund taxation which included amongst others the reduction of the opportunity to evade tax and the consistent tax treatment between public and private sector retirement funds (Liebenberg, 1996). The Minister of Finance also indicated that more time is needed to refine the details due to the complexity of the issue and the consultations that needed to be held (Liebenberg, 1996). The Minister of Finance also proposed a 17 per cent tax on all pension, provident and retirement annuity funds for insurers and retirement funds with effect from 1 March 1996 which led to the promulgation of the Tax on Retirement Funds Act 38 of 1996 which was subsequently amended over the years (Liebenberg, 1996).

A retirement fund reform paper was subsequently developed by National Treasury in 2004 with its main objective to amend the Income Tax Act 58 of 1962 (ITA) to align with the emerging

economy of the new democratic South Africa as the Act that governs pension funds was promulgated in 1956 (National Treasury, 2004). It was found that the retirement fund system promulgated in 1956 did not align with the new democratic South Africa and does not provide for the needs of South Africans, as the systems that govern the funds were weak and retirement tax was too high and costly (Mamabolo, 2015). Continuous reforms made to the retirement fund's systems policy necessitated changes to the tax treatment as policy goes hand in hand with tax.

In the 2007 Budget Speech, the former Minister of Finance, Mr Trevor Manuel, announced the abolishment of the retirement fund tax from 1 March 2007 for retirement funds (Manuel, 2007). Following the Minister's announcement in the Budget Speech, the Taxation Laws Amendment Act (TLAA) 8 of 2007 was passed to provide regulation for the taxation of retirement lump sum benefits. Before 1 October 2007, the tax on lump sums was calculated in terms of the average rate of tax of the individual which was applicable in terms of Section 5(10) of the ITA and the tax-free portion of the lump sum was calculated using a formula known as formula A and capped in terms of formula B (SARS, 2007).

From 1 October 2007, formula A was scraped, and formula B was simplified to state that the tax-free portion of the lump sum benefit is R300 000, and the taxable portion of the lump sum was included in the taxpayer's gross income (SARS, 2007). This led to the introduction of separate scale tables that were used to calculate the tax payable on retirement lump sum benefits wherein the tax was calculated at a sliding scale. In 2009, the ITA was amended to include a separate tax table for the tax on lump sums from withdrawal benefits wherein a sliding scale is used to calculate the tax payable. The tables introduced in 2007 and 2009 for retirement lump sum benefits and retirement withdrawal benefits respectively are still being used today with a few changes made over the past few years to the scales and the tax-free portions. Contributions to the pension, provident and retirement fund by a natural person that were tax deductible in the hands of the natural person were amended over time to expand on the provisions and eventually be capped at R350 000 a year (section 11F of the ITA).

Currently, all lump sums received from retirement funds, including severance benefits, are included in the natural person's gross income when calculating the taxable income in terms of special inclusion paragraph (e) of the gross income definition (section 1 of the ITA). Annuities from retirement funds are specifically included in the gross income when calculating the taxable income as defined in paragraph (a) of the gross income definition (section 1 of the ITA). Therefore, lump sums received by the employee from either the employer or fund, severance benefits and annuities are all specifically included in the gross income definition of a natural person when calculating the taxable income (section 1 of the ITA). However, the natural person qualifies for certain deductions in terms of paragraph 5 and 6 of the Second Schedule of the ITA that can be claimed against lumps sums received from funds and exemptions for qualifying annuities in terms

of section 10C of the ITA, provided all requirements are met. Even though all retirement amounts received are specifically included in the gross income, it is taxed using separate tax tables. Any retirement fund lump sums received are taxed according to the provisions of the Second Schedule of the ITA whilst the monthly annuities are taxed in terms of the normal tax tables (section 5 of the ITA). Severance benefits, as defined in section 1 of the ITA are specifically included in terms of the provisions of paragraph (d) of the gross income definition of the ITA and will be taxed using a special tax table similar to the tax table used to tax retirement fund lump sum benefits.

During the Covid-19 pandemic in 2020, many people across the world were cashing out their retirement funds by resigning from their employment due to the inability to work and earn money ultimately resorting to accessing their retirement funds as a means of financial assistance. Countries like Australia provided temporary relief by allowing participants to withdraw from their retirement funds to ease the financial difficulty brought about by the pandemic (Bateman, 2023). The Covid-19 pandemic highlighted the pressing necessity for a country's government's retirement system that offers mandatory preservation alongside the flexibility to access short-term savings for financial security (Bloom, 2023). The economic hardships induced by the Covid-19 pandemic emphasised the fact that, for numerous individuals in South Africa, there were circumstances whereby immediate financial requirements took precedence over long-term retirement savings (Bloom, 2023).

In the 2021 mid-term Budget Speech, Minister of Finance, Mr Enoch Godongwana, announced the introduction of a two-pot retirement system which entailed providing flexibility to natural persons contributing to a retirement fund by providing partial access to the retirement fund prior to the natural person's retirement from the fund (Godongwana, 2021). National Treasury is implementing the two-pot retirement system in South Africa that is commonly known as early access to retirement funds in other countries, that allows members of retirement funds to withdraw a certain portion of their funds for urgent financial needs that arise before retirement from the retirement fund. According to the data from the South African Revenue Service (SARS) and retirement fund administrators (National Treasury, 2022), individuals are withdrawing from their retirement funds before retirement date irrespective of the high tax rates that apply to such withdrawal amounts.

From the above it can be seen that one of the key reasons for South Africa to implement the two-pot retirement system was the lack of access to the funds in a retirement fund for individuals as they only had access to it by either at terminating from their employment or at retirement from the fund when they reach the age as set by the retirement fund. The provisions of the two-pot retirement system include that one-third of a natural person's contributions will go into a savings pot and the other two-thirds of contributions will go into a retirement pot and the natural person can withdraw a certain amount, once a year, from their savings pot, which is different from the

original retirement funds where a natural person could only access their funds in a retirement fund at resignation or retirement. The two-pot retirement system further provide that all withdrawals from the savings pot will be included in the natural person's gross income and in their taxable income which will subsequently be taxed using the normal tax tables (National Treasury, 2024).

Therefore, from the above, it is seen that the South African retirement system is undergoing major overhauls, consequently directly affecting the tax treatment of funds in retirement funds.

1.2 Literature review of the topic/research area

Randolph (2019) asserts that a literature review serves to demonstrate that the author has knowledge of the topic of study and assists the author with formulating a research problem by identifying gaps in the existing research and identify the need for more research that needs to be done. Snyder (2019) established that combining findings of multiple studies can help address the research problem at hand as it has more weight compared to a finding of a single study. Therefore, the current research literature should be thoroughly analysed to find the gap in research of retirement tax.

A literature review was performed to gain an understanding of the retirement tax, the reform of retirement tax and changes made to the provisions of the ITA particularly that relate to the tax treatment of retirement lump sum benefits, withdrawal benefits and early access to retirement funds. The ITA sets out how payments received by natural persons from retirement funds should be taxed in a South African context.

For review, academic sources such as Master's reports, articles and PhD research reports were reviewed and analysed. A study was conducted by Mans in which a comparison of the tax treatment of cross border retirement fund payments was made between South Africa, Australia, Canada, New Zealand, and the United Kingdom (UK) (Mans, 2021). It was established that South Africa is lenient on the taxing of non-residents as non-residents will only be taxed on retirement benefits in South Africa for services rendered in South Africa and paid by South African retirement funds (Mans, 2021). It was also found that South Africa is too lenient in the taxing of residents compared to other countries as South Africa give their residents an exemption in terms of s10(1)(gC) of the ITA on cross border retirement benefits while other countries aim to tax their residents on foreign retirement benefits (Mans, 2021).

Saunders and Volschenk (2022) carried out a study on the impact of the proposed two-pot retirement system on the middle-income class individuals. It was noted that the South African middle-income class individuals are defined as households representing average income of all South African households (Saunders & Volschenk, 2022). Saunders and Volschenk recommended that the two-pot retirement system should not be implemented due to the

tremendous impact it will have on the amounts of savings such individuals will have at retirement likely forcing people to be dependent on government grants and the increase in the administrative burden for SARS and retirement funds (Saunders & Volschenk, 2022). It was also recommended that further research can be done on the possible tax loopholes of the proposed two-pot retirement system (Saunders & Volschenk, 2022). The research will attempt to look at possible loopholes in tax treatment of two-pot retirement system.

An article indicated that the United States of America (USA) Internal Revenue Code discourages early access to pension funds by imposing a penalty tax on amounts withdrawn to discourage individuals from withdrawing amounts because if individuals withdraw funds early it will result in reduced amounts being available to the employee at retirement (Nys *et al.*, 2017). A comparison of early access to pension plans between USA and Belgium was made and it was found that the USA pension system has more options for access to the pension fund compared to the Belgian pension system (Nys *et al.*, 2017). This is important because it illustrates how tax policies influence early access to retirement funds, providing a basis for comparing South Africa's tax treatment with international systems.

A study was carried out by Xiang (2021) on the advantages and disadvantages of early access to retirement funds and found out that although early access provides more flexibility to natural persons in the short term, it has a negative long-term impact as it jeopardises the retirement savings available at actual retirement.

A study was carried out by Kimathi (2015) on the effect of early access to retirement benefits on pension schemes in Kenya. The study used a random sample of 80 pension schemes out of a population of 1 200 duly registered pension schemes. The results of the study indicated that there was a slight adverse correlation between the early access of benefits and the financial performance of pension schemes in Kenya and indicated that continued early access can pose a financial challenge to pension schemes in the long run (Kimathi, 2015).

An international study was performed on the capping of the deductibility of retirement fund contributions by natural persons per year of assessment following the amendment of the legislation to cap the annual deduction to R350 000 per section 11F of the ITA and it was found that the change was in line with certain developed countries (du Plessis, 2015). Implying that s11F of the ITA is in line with international norms so the fairness of the provision will be beyond the scope of this research.

As the process for the implementation of the two-pot retirement system is currently underway, limited studies could be found regarding the two-pot retirement system. National Treasury papers,

Parliament papers, draft SARS documents and other sources were consulted to gain an understanding of the gap that still needs to be filled.

Based on the above, no detailed comparative study could be found of solely the tax treatments of retirement lump sum benefits and withdrawal benefits between South Africa, Australia, Canada, the UK and the USA. Nor any studies of the two-pot retirement system with an analysis of which other countries have the system in place. What is clear from the review of the studies conducted is that the authors focus on the policy rather than the tax implications. This research intends to fill that gap by looking at the tax implications.

1.3 Motivation of topic actuality

A vast number of South African citizens are emigrating to other countries due to the rising unemployment rates, political uncertainties, and a stagnant economy in pursuit of greener pastures (BusinessTech, 2023). The South African Government Pensions Administration Agency received almost 4 600 resignations from Government Employees Pension Fund (GEPF) members in November 2014 of which most members were very close to retirement (Macupe, 2015). In the 2022/2023 financial year, GEPF received a total of 27 229 resignations which was an increase from the 20 659 cases received in 2022 (GEPF, 2023). Unfortunately, no information was found on how far these members were from retirement. The information from the 2014 retirements, indicates that members were not aware of the income tax implications of resigning compared to that of retirement from a retirement fund, notwithstanding the benefits they stand to lose, such as guaranteed pensions for their entire life. This research therefore intends to distinguish the tax implications between early access, resigning and retiring and how it compares to other international countries.

With the latest changes currently underway in the retirement system in South Africa that led to the introduction of the two-pot retirement system which is set to be implemented in the 2024/2025 tax year, there is limited to no academic research found on the tax treatment of the two-pot retirement system in South Africa. As the process of implementation is still ongoing, the topic is relevant as the study will analyse the proposed tax implications of the two-pot retirement system and how it will affect the current tax system.

In the literature review, no comparison could be found where the tax treatment of the funds at retirement is compared between South Africa, Australia, Canada, the UK, and the USA. It is important to benchmark the South African tax rules against those of other countries in light of the retirement changes to the retirement fund in terms of income tax, as it allows for an evaluation of fairness and effectiveness in the revamped retirement regime. It is important for South African citizens emigrating to understand how the retirement tax of South Africa differs with that of other

countries should they relinquish their tax residency in the process of emigrating for better employment opportunities.

The countries purposively selected for the international comparison are Australia, Canada, the UK, and the USA. The four selected countries are part of the top five countries where South African citizens are emigrating to with the UK hosting 217 180 South Africans (Fraser, 2024). The selected countries are members of the Organisation for Economic Co-operation and Development (OECD) which generally indicates that their tax policies follow best practises. The four selected countries also have a retirement system that allows early access to the funds in a retirement fund which is similar to the South African proposed two- pot system. Comparing South Africa to the selected developed countries and OECD member countries will give a clear indication of the differences between the South African income tax implications and the income tax implications of developed countries enabling us to benchmark and improve the South African tax rules if needed.

Considering the points provided in the literature review as shown above, it would be relevant to establish whether the taxation of retirement funds in South Africa, specifically pertaining to early access to funds and at resignation and retirement, (pension fund lump sums, monthly pension annuities and the proposed two-pot retirement system) compares to the taxation in Australia, Canada, the UK, and the USA with the aim of benchmarking and identifying areas for potential improvement. This research intends to fill the gap identified in the literature review.

1.4 Problem statement and research question

The South African retirement funds regime has undergone significant reforms over the past two decades, leading to numerous amendments to the ITA. The latest reform that was recently implemented included the introduction of the two-pot retirement system, allowing a natural person's partial access to funds in the retirement fund before retirement age.

However, as indicated above in the literature review, there is limited literature and studies available to comprehensively understand the income tax implications associated with these changes. The problem that arises is the lack of knowledge by ordinary residents of the income tax implications of retirement funds either at retirement, resignation, death or early access to the funds in the retirement fund brought in by the implementation of the two-pot retirement system on 1 September 2024. The evolving nature of retirement fund legislation presents challenges for ordinary residents to navigate the complexities of the tax treatment.

Therefore, the research question is: How does the South African tax treatment of retirement funds at early access to the funds, at retirement, resignation and death compare to that of Australia, Canada, the UK, and the USA?

1.5 Research objectives

1.5.1 Main Objective

The primary objective of the study is to determine how the income tax implications of funds received at early access to the funds in a retirement fund at retirement, resignation and death differ between South Africa, Australia, Canada, the UK, and the USA in order to benchmark the South African tax provisions of retirement funds for possible recommendations.

1.5.2 Secondary Objectives

The following secondary objectives are set to address the main objective of the study:

- i. To analyse the development in the income tax treatment of retirement funds in South Africa from 1994 to date (Chapter 2).
- ii. To analyse what the South African proposed two-pot retirement system entails and the tax implications thereof (Chapter 3).
- iii. To analyse the income tax treatment of retirement funds at early access to the funds and at retirement, resignation and death of Australia, Canada, the UK, and the USA (Chapter 4).
- iv. To identify differences in the income tax treatment between South Africa and the selected developed countries (Chapter 4).

1.6 Research methodology

1.6.1 Research paradigms

Research paradigm is a set of beliefs or worldwide view of how the researcher sees and interprets the world which in turn informs the interpretation of the data that is intended to be used for the research action (Randolph, 2019). Researchers must choose the research paradigm that aligns with their beliefs and world views to ensure strong research design (Snyder, 2019).

There are two types of research paradigms, postpositivist and interpretivist (McKerchar, 2008; More, 2015). In a positivist paradigm, it is assumed that objective reality exists autonomously from human perception or interpretation and the ontological position is that of realism. According to Kivunja (2017), the epistemological stance of a positivist is characterised by objectivism. Positivists research normally follows a quantitative approach as it generates numeric data most of the time (Mills *et al.*, 2006).

The interpretivist paradigm assumes that social reality is influenced by human experiences and that truth and knowledge are subjective due to differences in culture and experiences (Levers, 2013). The interpretivism paradigm will be used in this research study as a qualitative

methodology that analyses legislations, and other resources will be used to obtain a deeper understanding of the tax treatments of different countries.

1.6.2 Ontological assumptions

The ontological perspective of qualitative research focuses on examining the relationships between individuals and society, rooted in interpretative sociology (Rehman & Alharthi, 2016). This perspective highlights the importance of understanding the subjective meanings, interpretations, and experiences of individuals within their social environments (Rehman & Alharthi, 2016). In qualitative research with an ontological basis in interpretative sociology, the focus is on exploring the intricate connections between people and their social environment, often using methods such as interviews, participant observation, and document analysis to capture rich, context-specific insights. This approach recognises the socially constructed nature of reality and seeks to uncover the diverse perspectives that individuals bring to their interactions and experiences within society.

This study focused on analysing income tax acts of various countries and National Treasury papers on retirement fund reforms to determine whether the South African income tax on retirement funds is in line with the tax of selected developed countries. The analysis was achieved through detailed review of South African and international tax legislations. As legislations are complex, they could be interpreted differently depending on the researcher and lead to each researcher reaching a different conclusion. And for that reason, this research study followed an interpretivist approach as conclusions depend on the researcher's point of view.

1.6.3 Epistemological assumptions

Epistemology is focused on how we can obtain the knowledge of reality (Pervin, 2022). This study considers the changes in the taxation of the retirement fund system following the reforms post 1994 to align the retirement industry to the new democratic South Africa post apartheid. The main objective of the study is to compare the South African income tax implications of retirement funds with the income tax implications of other jurisdictions to benchmark how the South African tax on retirement compares with the tax in selected developed countries (see motivation for selection in 1.3 of this research). The objective was achieved by thoroughly reviewing the South African tax legislation, National Treasury Papers on retirement reform, SARS interpretation notes, foreign tax legislations and other materials.

1.6.4 Methodological assumptions

Methodology is defined as a philosophical stance or worldview that underlies and informs the research style (Jupp & Sage, 2006). Methodology includes epistemology which is the reason for

the validity of conclusions and ontology which is about which information to read in order to reach the conclusion. Methodological assumptions affect how the researcher collects and analyse the information for the research. The assumption is that developed OECD countries may well have good retirement fund rules relating to taxation.

The development of the South African income tax legislation following the retirement system reform by the National Treasury was studied by going through the National Treasury papers as well as legislation amendments post 1994. Income tax legislation of selected developed countries were studied and interpreted to determine whether the South African income tax on retirement funds is in line with the income tax levied by the selected developed countries.

Qualitative research is conducted in an interpretivist paradigm which assumes that reality is socially constructed and subjective. In a qualitative methodology, several theoretical frameworks already exist and therefore the main aim of a qualitative research is finding solutions to problems and not trying to disprove the evidence already out there (Jupp & Sage, 2006).

Therefore, based on the above, this study followed a qualitative approach and comparative research method due to the fact no quantitative data was collected and analysed and that it performed an international comparison between South Africa and selected developed countries.

1.7 Ethical considerations

No personal information was used in the study as it is qualitative in nature and no data was collected. All the sources used for this study were referenced. No permissions were needed to use the sources in the study as they are accessible to the public through the internet. Ethical clearance was obtained through the NWU Ethics Committee, and the study poses very little risk as no human interaction is involved.

1.8 Chapter Overview

Chapter 1: Introduction

This chapter provides the background, motivation of the study, problem statement, research objective and the research methodology used for the study.

Chapter 2: Development of the ITA with regards to the taxation of funds at retirement

This chapter analyses significant changes in the South African income tax legislation from 1994 to date with regards to the taxation of retirement fund benefits necessitated by the reform in the South African retirement system. This chapter addresses the secondary research objective as identified in par 1.5.2(i).

Chapter 3: South African income tax implication of retirement funds at early access of funds, retirement or death and resignation

This chapter provides an analysis of the current income tax implications at retirement, resignations and death for South African residents in terms of the ITA. The chapter also analyses the proposed tax implications and the chosen tax implication of the two-pot retirement system. This chapter addresses the secondary research objective as identified in par 1.5.2(ii).

Chapter 4: Comparison and Analysis between the income tax in South Africa and the income tax in selected developed countries

This chapter provides an analysis of the income tax treatment of funds from retirement funds at early access, resignation, retirement and death as per the income tax systems of Australia, Canada, the UK, and the USA. The main aim of the chapter is to determine how the income tax treatment differs or is similar to that of South Africa. This chapter addresses the secondary research objectives as identified in par 1.5.2(iii) and par 1.5.2(iv).

Chapter 5: Summary and Conclusion

The chapter provides a summary of the findings of the study and answers the research question. It also includes recommendations of how the ITA can possibly be amended to align with the income tax treatment of the selected developed countries.

CHAPTER 2: DEVELOPMENT OF THE ITA WITH REGARDS TO THE TAXATION OF FUNDS AT RETIREMENT

2.1 Introduction

Post 1994, there have been numerous changes in income tax legislation in relation to the tax treatment of funds at retirement with the most recent changes regarding the two-pot retirement system implemented in September 2024. A vast number of the amendments to the income tax legislation regarding taxation of funds from retirement funds at retirement were following the recommendations of the Katz commission. Due to speculations surrounding retirement fund taxation, individuals were contemplating early retirements or resignations fearing higher taxes on lump sums (Department of Finance, 1996). The government assured members that there is no reason for the panic and committed to only effecting changes from 1 March 1997 should the new proposed tax dispensation be disadvantageous when compared to the current income tax system (Department of Finance, 1996).

This chapter provides the historical changes in the income tax of funds from retirement funds commencing from 1994 till date. This includes examining the amendments to the relevant sections in the ITA and the National treasury papers. This chapter addresses the secondary research objective as identified in par 1.5.2(i) to analyse the development in the income tax of retirement funds from 1994 to date in order to obtain an understanding of the evolution of the tax treatment

2.2 Retirement funds tax

Previously under the EET system, income generated by the fund in the form of growth in retirement contributions was exempted from tax (JSCOF, 1999). The Katz Commission recommended that the rental, interest, and other trading income received by approved retirement funds as defined in the Pensions Fund Act 24 of 1956 be taxed at a flat rate of 30%. The recommendation to tax retirement funds at a flat rate was adopted by the National Treasury with effect of 1 March 1996 wherein 17% was imposed on the monthly gross interest and net rental received by all public and private sector pension, provident and retirement annuity funds (Liebenberg, 1996). However, the 17% tax was subject to certain provisions including that the rental and interest income related to assets attributable to pensioners and annuitants who started receiving benefits on or before 1 March 1996 or whose benefits will start during the year of assessment to 29 February 1997 will not be subject to the 17% tax. In the 1997 budget speech, the Minister of Finance noted that the government does not intend to make any major changes in the present structure or rate as they are still waiting for proposals from the National Retirement Consultative Forum (Manuel, 1997). The retirement tax rate was revised to 25% effective 1 March 1998, then reduced to 18% on 1 March 2003, and further decreased to 9% on 1 March 2006. The

Retirement fund tax was ultimately abolished on 1 March 2007 as a measure to encourage retirement savings (Manuel, 2007).

2.3 Equal treatment between public and private sector funds

Before 1998, lump sum benefits received by members of public sector funds were not taxable. Public sector retirement funds are retirement schemes established by law or for the benefit of local authorities. On the other hand, lump sum benefits received by members of private sector retirement funds were liable for income tax. The challenge posed by this disparate tax treatment was the perceived inequity and lack of fairness between public sector and private sector retirement fund members regarding the income tax treatment on their lump sum benefits (JSCOF, 1999).

The Katz Commission and the National Retirement Consultative Forum both suggested that it is important for members of both public and private sector retirement funds to receive equal treatment on the income tax of lump sum benefits (Manuel, 1997). The main aim of the recommendation was to promote equality and fair tax treatment regardless of one's employment sector. Following the recommendations, the Minister of Finance announced in the 1997 budget speech that equality between the public and private sector retirement funds income tax treatment will be introduced from 1 March 1998 but subject to protection of vested rights (Manuel, 1997). This meant that lump sum payments from retirement funds will be taxed, for income tax purposes, the same regardless of whether the member was from a public or private sector fund. However, the protection of vested rights meant that all benefits accrued in the public sector retirement funds prior to the effective date of 1 March 1998 would remain tax free therefore making all benefits from 1 March 1998 subject to income tax.

The ITA was amended to include Formula C in paragraph 1 of the Second Schedule of the ITA which determined the taxable portion of a member's lump sum benefit in a retirement fund by calculating the portion relating to membership after 1 March 1998 derived by a member of a public sector pension fund (National Treasury, 1998a). To determine the portion of public sector lump sum benefits, subject to tax, the formula (Formula C) was calculated as follows:

$$A = \frac{B}{C} \times D$$

Where the above letters in the formula relate to the following:

- A related to the tax amount for public sector lump sum benefits.
- B represented the number of years of membership to the public sector fund from 1 March 1998.
- C represented the total number of years of membership to the public sector fund.

- D represented the lump sum benefit payable to member.

The Income Tax Act 28 of 1997 also amended paragraph 2 of the Second Schedule of the ITA to include the wording subject to the provisions of paragraph 2A. Paragraph 2A of the Second Schedule of the ITA stated that the amount to be included in the special inclusion paragraph (e) of the gross income definition (section 1 of the ITA) for all lump sum benefits received from a public sector retirement fund shall be deemed to be an amount equal to the amount determined by Formula C. However, for lump sum benefits from other retirement funds other than public sector funds, the amount to be included in the special inclusion paragraph (e) of the gross income (section 1 of the ITA) shall be the aggregate of all the lump sum benefits received or accrued by the taxpayer in any year of assessment from retirement funds. Former public sector retirement fund members who transferred their benefits to private sector funds were still entitled to the tax-free portion of all pre-1998 benefits when they exit the private sector retirement funds (National Treasury, 1998b).

Effective, 1 March 2006, paragraph 6 of the Second Schedule of the ITA was amended by the TLAA 8 of 2007 to allow a deduction of the tax-free amount as determined by Formula C from the withdrawal benefit if a benefit is transferred from a public sector retirement fund to a non-public sector retirement fund. Following this, an amendment was made to paragraph 5 of the Second Schedule of the ITA by the TLAA 17 of 2009 to allow a deduction for the tax-free portion as calculated by Formula C from the retirement benefit if a benefit was transferred from a public sector retirement fund to a non-public sector retirement fund effective transfers from 1 March 2009. When a member resigned from the retirement fund or retired from the fund, the member would be entitled to a deduction of the tax-free portion of the pre-March 1998 benefits as determined by Formula C from the withdrawal or retirement benefits. The amendments to paragraph 5 and 6 of the Second Schedule of the ITA only applied to the first transfer from a public sector retirement fund to a pension fund, pension preservation fund, provident fund, provident preservation fund or a retirement annuity fund.

In 2012, the TLAA 22 of 2012 amended the ITA to move Formula C from section 1 of the Second Schedule of the ITA to paragraph 2A of the Second Schedule of the ITA. This meant that all the paragraph 5 and 6 deductions for the tax-free portion for pre 1998 benefits will now be determined by the formula in paragraph 2A of the Second Schedule of the ITA. This resulted in all pre-1998 tax free retirement benefits retaining their tax-free status on either withdrawal or retirement.

The amendments discussed above have successfully equalized the tax treatment between the public and private sector retirement funds ensuring consistent and fair tax treatment between the different funds regardless of one's employment sector.

2.4 Development in the taxation of retirement lump sum benefits

In 2007, the taxation of the lump sum benefits on retirement was simplified. Before 1 October 2007, the tax-free portion of lump sum payments from a retirement fund was determined in terms of Formula A and capped in terms of Formula B (SARS, 2007). The formulas considered the number of years the person was a member of the retirement fund and the highest annual average salary during any five consecutive years (SARS, 2007). The tax-free portion was limited to the maximum of the greater of R120 000 or R4 500 multiplied by the number of years of membership to the retirement fund. The taxable portion after subtracting the tax-free portion as determined by Formula A and B was then calculated using the averaging formula which considered the highest average annual tax rate for the year in which the lump sum benefit is payable or the previous year (SARS, 2007). The need for change to a simplified approach was prompted due to the fact the formula's used were complex and dependant on information that was not easily accessible (National Treasury, 2007). The tax payable on the taxable portion was also difficult to calculate and the averaging formula was used as a planning tool by some individuals wherein high earning individuals would suppress their taxable income for the two-year period to retirement in order to limit the average tax rate on the lump sum (National Treasury, 2007). The TLAA 8 of 2007 was passed to provide for the new regime of the taxing of retirement lump sum benefits. Following the amendment, Formula A was repealed, and Formula B simplified. With the simplification of Formula B, the tax-free portion was now calculated as a sum of R300 000, own contributions not permitted as a deduction less previous deductions against the lump sum (National Treasury, 2007).

The taxable portion which is the lump sum benefit after deducting the tax-free portion as calculated by the simplified Formula B is included in the taxpayer's gross income in terms of the special inclusion paragraph (e) of the definition of gross income (section 1 of the ITA (SARS, 2007). The averaging formula was removed and replaced by a simplified tax rate table which was different from the normal tax tables. In terms of the new tables, apart from the initial tax-free lump sum of R300 000 mentioned above, any amount from R300 001 to R600 000 will be taxed at a fixed rate of 18%. Similarly, any amount falling between R600 000 and R900 000 will be taxed at a fixed rate of 27%. Furthermore, any amount exceeding R900 000 will be taxed at a fixed rate of 36%. The new amendments applied to all retirement lump sums received on or after 1 October 2007.

The TLAA 17 of 2009 amended the ITA to delete the entire Formula B from section 1 of the Second Schedule of the ITA effective 1 March 2009. This effectively removed the R300 000 exemption or tax-free portion and made it part of the special rates table used to tax retirement lump sum benefits. The tax-free portion was increased to R315 000 effective 1 March 2011 meaning that the first R315 000 of the retirement lump sum benefit was not subject to tax. In the

2014 Budget Speech, the Minister of Finance announced an increase of the tax-free portion of retirement benefits on retirement or death from R315 000 to R500 000 effective 1 March 2014. The reason for the increase was to benefit the low-income earners who did not benefit from the contribution's deduction (Gordan, 2014). The tax-free portion was later increased to R550 000 on retirement or death effective 1 March 2023 and remains unchanged presently.

The amendments to the taxation of retirement lump sum benefits on retirement or death, particularly the transition from the complex Formula B to a simplified special tax table with an embedded tax-free portion, have reduced opportunities for tax planning strategies and significantly enhanced the efficiency and equity of retirement fund taxation.

2.5 Development in the taxation of withdrawal (resignation) lump sum benefits

Prior to 1 March 2009, the first R1 800 of any withdrawal benefit was exempt from tax. The remaining taxable portion of the withdrawal lump sum benefit was taxed using the averaging formula in terms of section 5(10) of the ITA. Unlike retirement lump sum benefits, withdrawal benefits continued to be subject to the average rate of tax and the R1 800 exemption as the changes made effective 1 October 2007 did not apply to withdrawal benefits. In the 2008 Budget Speech, the Minister of Finance indicated that a simplified approach will be made for withdrawals from retirement funds (Manuel, 2008). The reasons for the change were the fact that the tax-free portion was very low and has not changed for many years (National Treasury, 2008). The averaging formula set out in section 5(10) of the ITA used to tax the withdrawal benefits was complex and depended on information that was not easily accessible (National Treasury, 2008).

Further complications arose when recurring payments like maintenance payments by court orders were made (National Treasury, 2008). The recurring payments were subject to tax as lump sums upon payment, but on assessment of the natural person's income tax, there could be additional tax payable, potentially leaving the retirement fund member without sufficient funds to cover the tax (National Treasury, 2008). The Revenue Laws Amendment Act No 60 of 2008 replaced the former R1 800 exemption for withdrawal benefits with R22 500 starting from year of assessment commencing on 1 March 2009. However, it did not include the separate sliding scale table.

The TLAA 17 of 2009 then later introduced a simplified approach to tax withdrawal benefits which included a sliding scale tax table, and it removed the R22 500 exemptions and made it part of the sliding scale table. In terms of the new table, the first R22 500 of the withdrawal benefit was exempt, any amount from R22 501 to R600 000 will be taxed at a fixed rate of 18%. Similarly, any amount falling between R600 000 and R900 000 will be taxed at a fixed rate of 27%. Furthermore, any amount exceeding R900 000 will be taxed at a fixed rate of 36%. The new amendments applied to all withdrawal lump sum benefits received from retirement funds for year of assessment commencing on or after 1 March 2009. The tax-free portion for withdrawal benefits was increased

from R22 500 to R25 000 effective 1 March 2014. The tax-free portion was later increased by 10% from R25 000 to R27 500 effective 1 March 2023 and remains unchanged presently.

These amendments to the taxation of withdrawal lump sum benefits have progressively simplified the tax treatment by replacing the complex averaging formulas with a clear sliding scale table. This also saw the increase of the tax-free portion over past few years consequently lowering the tax liability for the members and providing greater income tax relief to individuals accessing their retirement savings by means of withdrawal.

2.6 Development in the treatment of contributions

Before the below proposals and amendments, section 11(k) of the ITA prescribed the deductibility of the employees' own pension fund contributions whilst section 11(n) prescribed the deductibility of retirement annuity fund contributions. Contributions made by the employee towards a provident fund were not deductible in the hands of the employee.

Employer contributions to pension and provident funds were tax free benefits in the hands of the employee whilst contributions made by the employer towards retirement annuity funds were taxable fringe benefits that were included in the gross income of an employee (Forster, 2014).

The employer qualified for a section 11(1) of the ITA income tax deduction for the retirement contributions made on behalf of employee's but the deduction was limited to 20% of the employee's remuneration (Forster, 2014). For an employee, contributions towards pension funds, were entitled to a section 11(k) of the ITA deduction which was the greater of R1 750 or 7,5% of their pensionable earnings but limited to the actual contributions made (du Plessis, 2015). On the other hand, employees were entitled to a section 11(n) of the ITA deduction on retirement annuity fund contributions they made for up to 15% of their non-pensionable income as long as the limit did not exceed the actual contributions made (Forster, 2014).

The TLAA 17 of 2009 amended section 11(n) of the ITA and paragraph 2(4)(bA) of the Fourth Schedule of the ITA to allow a deduction for contributions to a retirement annuity fund in the employee's hands despite the fact that the contribution was paid by someone else on their behalf.

In the 2011, Budget Speech, the Minister of Finance, proposed a change in the tax treatment for pension and provident fund contributions to include the treatment of employer's contributions as a fringe benefit and to align the tax treatment of provident funds and pension funds (Gordan, 2011). It was further proposed that employees be allowed to deduct the lesser of 22,5% of the taxable income for contributions to retirement funds or an amount of R200 000 for the year of assessment as long as it does not exceed the contributions made (Gordan, 2011). The proposal

was set to be effective from the 1 March 2012. However, the proposal was not adopted in 2012 due to ongoing consultations.

The Minister of Finance announced in the 2012 Budget Speech that the reform regarding the contribution deductions is set to take effect in the 2014 tax year and made further proposals in the budget review for public consultation (National Treasury, 2012). The following proposals were made:

- Contributions made by both employees and employers to pension, provident, and retirement funds will be deductible in the hands of employees.
- The deductions for employees will be determined as 22.5% and 27.5% of the higher amount between employment or taxable income, depending on whether they are below 45 years old or 45 years and above, respectively.
- These deductions will be capped annually at R250,000 for taxpayers below 45 years old and R300,000 for those above 45 years old.

Following the 2012 public consultations on the Draft Retirement Reform Proposals Paper, the Minister of Finance announced the new proposals considering the results of the consultations in the 2013 budget review which are as follows (National Treasury, 2013).

- “Employees contributions to pension and retirement annuity funds becoming tax deductible”.
- “Employer contributions to pension, provident and retirement annuity funds to be treated as a fringe benefit and taxable in the hands of the employee”.
- “The employee qualifies for a deduction on both the employer and employee contributions up to 27.5% of the higher of remuneration or taxable income (excluding retirement annuity or lump sum income)”.
- “The deduction will be capped to R350 000 per annum irrespective of age for fairness purposes”.
- “Unused deductions exceeding of the R350 000 cap will be rolled over to future years”.
- “Harmonisation of the tax treatment of contributions to pension, retirement annuity and provident funds so provident fund members get the same tax deduction”.

Following the budget review, The TLAA 31 of 2013 was passed to amend the ITA to include the above proposals that were made in the 2013 budget review effective 1 March 2015. However, on 16 October 2014, the National treasury announced the delaying of the implementation date of the tax treatment of contributions from 1 March 2015 to 1 March 2017 due to further consultations with the National Economic Development and Labour Council (NEDLAC) (National Treasury, 2014). The TLAA 25 of 2016 amended the ITA to amend section 11(k) to include the above

proposals effective 1 March 2016 due to finalisation of consultations with NEDLAC. The TLAA 17 of 2017 retrospectively amended the ITA to delete section 11(k) and to move the provisions regarding the deduction in respect of contributions to all retirements funds to section 11F of the ITA deemed to become effective on all years of assessment starting on or after 1 March 2016.

The key reasons for the changes were to harmonise the tax deductibility of contributions across all retirement funds where the same deduction applies to both employee and employer contributions irrespective of whether it's a pension, provident or retirement annuity fund (National Treasury, 2017). The other reasoning behind the revised deductibility of contributions was to promote retirement savings by giving households an income tax incentive so they have enough savings when they retire (du Plessis, 2015).

2.7 Annuitisation of provident and provident preservation funds

Pension and retirement annuity fund members were bound by a compulsory annuitisation clause that requires members to take, at retirement or death, one third as a lump sum and the other two thirds of the total retirement interest in the retirement fund to be paid out in a form of a living annuity (National Treasury, 2013). The computation of the annuity was subject to the *de minimis* limitation. The *de minimis* limitation meant that if the total value of the retirement interest in the retirement fund did not exceed R75 000, the member was allowed to take the full retirement interest as a lump sum and not commute the two thirds as an annuity (National Treasury, 2013). The *de minimis* limitation was increased from R75 000 to R247 500 effective 1 March 2016. The reason for limitation was the fact that it was not cost effective, for the retirement fund, to administer the annuity for any amount below the *de minimis* amount (National Treasury, 2013).

However provident fund and provident preservation members were not required to annuitise and would receive their full retirement interest upon retirement or death. In 2013, it was proposed that the same annuitisation rules that apply to pension, and retirement annuity funds should apply to provident funds effective 1 March 2015 (National Treasury, 2013). The implementation of the annuitisation of provident and provident preservation funds was postponed several times between 2015 and 2020 due to it being challenged by labour unions (Chong, 2021). There was a misconception that the proposal by government to annuitise provident funds was to nationalise them (Chong, 2021). The mandatory annuitisation of pension funds became effective 1 March 2021 after an agreement was made with all NEDLAC constituencies (Chong, 2021). The TLAA 20 of 2021 amended the ITA to include the provisions for the annuitisation of provident and provident preservation funds. The *de minimis* rule that applied to pension and retirement annuity funds also started to apply to provident funds. However, to protect historic vested rights, the following was implemented:

Members of provident and provident preservation funds who are 55 years or older on 1 March 2021 would have the following implications:

- These members were not affected by the changes. They will still be allowed to take 100% of their retirement interest in cash provided their benefits remain in the same provident fund until they retire or die.
- Should the member transfer to another fund, all contributions made and the growth thereof from the date of transfer will be subject the annuitisation at retirement wherein one third will be paid out in cash as a lump sum. The vested portion which relates to all contributions and growth on 1 March 2021 will be paid out in cash at retirement or death.

Members of provident and provident preservation funds who were younger than 55 years on 1 March 2021 would have the following implications:

- Such members had to split their benefits between the vested member share and the non-vested member share.
- Members were allowed to take the full vested portion of the retirement benefit in cash at retirement which includes all contributions and growth until 1 March 2021.
- The non vested portion which relates to all contributions and growth after 1 March 2021 will be subject to the annuitisation rules wherein a maximum of one third can be taken as a lump sum at retirement. However, this is subject to the *de minimis* rule

Annuitisation does not apply to withdrawal of benefits and if a member withdraws before reaching the retirement age, they will have access to the full retirement savings. One of the key reasons to annuitize provident funds was that retirees were depleting their retirement funds too quickly before the end of their retirement years leaving them with no other income to sustain themselves (National Treasury, 2013).

2.8 Two-pot retirement system

The Covid-19 pandemic prompted many countries to contemplate allowing individuals to tap into retirement fund savings as a temporary relief measure for natural persons experiencing financial difficulty. During the Covid-19 pandemic, National Treasury received a number of proposals from taxpayers and certain NEDLAC social partners to allow early access to retirement fund savings due to Covid-19 (National Treasury, 2020). The National treasury consulted with NEDLAC partners, trade unions, regulators, and other stakeholders to discuss how to allow for such withdrawals without creating liquidity and investment risks (National Treasury, 2021a). National treasury highlighted that implementing of such a new system will take time due to consultations and legislative amendments (National Treasury, 2021a).

On 16 December 2021, the National Treasury published a discussion paper for public consultation which highlighted two main concerns of the retirement policy prior to the amendment: insufficient preservation of funds before retirement and taxpayers in financial difficulties could only access their retirement savings funds through resignation leading to fewer savings at retirement (National Treasury, 2021b). SARS levies a significant tax on withdrawal benefits as a way to stop people from depleting their retirement savings before retirement. However, despite the high tax, individuals are still withdrawing their retirement savings. 2021 data from SARS revealed that in each of the past three years, more than 700 000 individuals cashed out a withdrawal lump sum benefit before retirement (National Treasury, 2021b).

The government proposed a structured two-pot retirement system wherein one pot will be preserved until retirement whilst the second pot will allow for early access for emergencies (National Treasury, 2021a). The one account can be accessed at any given time but only once a year whereas the other account is only accessible at retirement (National Treasury, 2021b). The two-pot distributes the lump sum that would have been available at retirement throughout the member's lifespan ensuring that money is accessible when most needed (National Treasury, 2021b). The two-pot retirement system eliminates the need for individuals to resign solely to access their retirement savings, as it allows for partial withdrawals while preserving long-term retirement savings.

After thorough consultations with the public, NEDLAC, retirement funds, regulators and various other stakeholders, legislative changes to the retirement system with the intent of allowing early access to retirement savings before retirement while preserving the remainder for retirement were set to take effect on 1 March 2024. The Minister of Finance proposed to Parliament that the implementation date of the two-pot retirement system be postponed to 1 September 2024 as more work was still needed to amend certain legislations and to give SARS more time to put their systems in place to deal with the withdrawal applications. The Revenue Laws Amendment Bill was passed by the National Assembly on 20 February 2024 with an effective date of 1 September 2024 to introduce the two-pot retirement system into tax laws (Parliament of the Republic of South Africa, 2024).

The two-pot retirement system comprise of three components as discussed below.

2.8.1 Vested component

The vested component includes all retirement contributions including growth that a member has accumulated prior to the implementation date, 1 September 2024. This component is protected as the two-pot rules will not apply to it. The component no longer takes any further contributions from 31 August 2024 but remains invested by the retirement fund. All rules that currently apply to the

retirement funds will continue to apply to the vested component. Meaning that should the member wish to resign, they can still obtain a withdrawal lump sum benefit, or at retirement only one third of the vested component will be paid out in cash as a lump sum and the remaining two thirds will be paid out in a form of a living annuity. A once off seed capital was transferred from the vested pot to the savings pot on 1 September 2024 (Allan Gray, 2024).

2.8.2 Savings pot

The savings pot starts with an opening balance of a once off seed capital transferred from the vested pot which is not taxable. The seed capital amount is the lowest of 10% of the retirement savings on 31 August 2024 in the vested pot or R30 000. The seed capital amount can be accessed immediately on 1 September 2024. One third of all contributions to the retirement fund from 1 September 2024 net of all risk premiums and admin charges will go towards the savings pot. The contributions in the savings pot will earn investment growth. Members will be allowed to withdraw once a year from the savings pot a minimum of R2 000 but limited to a maximum of R30 000. An administration fee will be charged on all withdrawals and the net amount after tax and administration charges will be paid over to the member. Members will also be allowed to transfer money from the savings pot to the retirement pot without any tax implications. Members can access the savings pot in all forms of exit namely retirement, death, or resignation. At retirement or resignation, members can take any balance in the savings pot in cash (National Treasury, 2021b).

2.8.3 Retirement pot

Two thirds of all contributions to the retirement fund from 1 September 2024 net of all risk premiums and admin charges will go towards the retirement pot. The contributions in the savings pot will earn investment growth. No amount can be transferred out of the retirement pot making it only accessible at retirement, retrenchment, or death. However, members who emigrate out of South Africa will be able to access the retirement pot as a lump sum after proving that they are not a South African tax resident for three years (Investec, 2024a). At retirement, 100% of the retirement pot will be paid out in the form of an annuity provided that the retirement savings is more than R165 000. Should the total value of retirement pot be less than R165 000 at retirement, the amount will be received by the member in cash as a lump sum (Bechard, 2024).

The two-pot retirement system applies to all retirement funds both public and private sector funds with exception to legacy retirement annuity policies and inactive funds such as dormant funds and funds in liquidation (National Treasury, 2024). The two-pot retirement system does not automatically apply to provident fund members who were 55 years or older on 1 March 2021

(National Treasury, 2024). However, the members may elect to take part in the two-pot retirement system should they wish to.

Only the vested pot and the savings pot are accessible at any form of exit. KPMG, one of the biggest four professional audit firms in South Africa, reiterated the need for a balance between short-term access and long-term preservation warning that the rapid implementation thereof could place a significant administrative burden on retirement funds and SARS (KPMG, 2022).

2.9 Summary of changes

Table 2-1 below provides an overview of the changes in the ITA and the retirement system post 1994 in South Africa as discussed above.

Table 2-1: Summary of all developments in the taxation of retirement funds (South Africa)

Effective date	Summary of change	Amendment Act
1 March 1996	A 17% retirement tax was introduced on the monthly interest and rentals received by retirement funds.	Tax on Retirement Funds Act 38 of 1996
1 March 1998	The 17% retirement tax rate was increased from 17% to 25%.	1998 Budget Speech
1 March 1998	Public sector funds retirement benefits from 1 March 1998 were subject to tax.	Income Tax Act 28 of 1997
1 March 2003	The 25% retirement tax rate was decreased from 25% to 18%.	2003 Budget Speech
1 March 2006	The 18% retirement tax rate was decreased from 18% to 9%.	2006 Budget Speech
1 March 2006	Paragraph 6 of the Second Schedule was amended to allow a deduction from the withdrawal benefit the Pre-March 1998 tax free portion as determined by Formula C of the Second Schedule when a benefit is transferred from public sector to private sector funds.	TLAA 8 of 2007
1 March 2007	The retirement fund tax was abolished.	TLAA 8 of 2007
1 October 2007	Simplification of the taxation of retirement lump sum benefits by deleting Formula A, simplifying Formula B, and introducing new tax tables to tax retirement benefits.	TLAA 8 of 2007
1 March 2009	Paragraph 5 of the Second Schedule was amended to allow a deduction from the retirement benefit the Pre-March 1998 tax free portion as determined by Formula C of the Second Schedule when a benefit is transferred from public sector to private sector funds	TLAA 17 of 2009

	• Formula B was deleted, and the tax-free portion for retirement benefits was now part of the separate sliding scale tax tables. • Simplification of the taxation of withdrawal benefits by using a sliding scale tax table • Deduction was allowed in the hands of employees for contributions to retirement annuity fund paid on behalf of the employee by a third party.	
1 March 2009	• The tax-free portion for withdrawal benefits was increased from R1 800 to R22 500.	Revenue Laws Amendment Act 60 of 2008
1 March 2011	• The tax-free portion for retirement lump sum benefits was increased from R300 000 to 315 000	2011 Budget Speech
1 March 2012	• Formula C from section 1 of the Second Schedule was moved to Paragraph 2A of the Second Schedule.	TAA 17 of 2009
1 March 2014	• The tax-free portion for retirement lump sum benefits was increased from R315 000 to R500 000 • The tax-free portion for withdrawal benefits was increased from R22 500 to R25 000	2014 Budget Speech
1 March 2016	• Contributions to pension and retirement annuity funds made by employees are tax deductible • Employer contributions to pension, provident and retirement annuity fund will be treated as a fringe benefit and taxed as such in the hands of the employee. • The employee qualifies for a deduction on both the employer and employee contributions up to 27.5% of the higher of remuneration or taxable income (excluding retirement annuity or lump sum income). • The deduction will be capped to R350 000 per annum irrespective of age for fairness purposes. • Any unused deductions in excess of the R350 000 cap will be rolled over to future years. • Harmonisation of the tax treatment of contributions to pension, retirement annuity and provident fund so provident fund members get the same tax deduction	TAA 25 of 2016
1 March 2016	• Section 11(k) of the ITA was deleted and section 11F was introduced to provide to the deduction of retirement fund contributions	TAA 17 of 2017
1 March 2021	• The annuitisation of provident and provident preservation funds was introduced	TAA 20 of 2021
1 March 2023	• The tax-free portion for retirement lump sum benefits was increased from R500 000 to R550 000 • The tax-free portion for withdrawal benefits was increased from R25 000 to R27 500	2023 Budget Speech
1 September 2024	• The two-pot retirement system that allows early access to retirement benefits without resignation was introduced	Revenue Laws Amendment Bill of 2024

Source: Author's compilation of information presented above

2.10 Conclusion

In this chapter, the significant amendments in the legislation with regards to the income tax Implications of retirement funds at retirement and withdrawal, including the deductibility of contributions, have been discussed together with the reasons for certain amendments. The harmonisation of retirement funds meant that there will be the same tax treatment irrespective of whether a person belongs to a pension, provident or retirement annuity or preservation funds.

The chapter also included an overview of the two-pot retirement system. It was found that the development of the tax legislation was influenced by various factors including the recommendation of the Katz Commission that was established primarily to address past imbalances. The reforms represented a shift towards an equitable and simplified tax system that intended to promote retirement savings for individuals. With the most recent changes being the annuitisation and the two-pot, the annuitisation of funds was brought in to ensure that retirees do not deplete their retirement savings and on the other hand, the two-pot solved the need for immediate access to funds for emergency whilst still promoting retirement savings.

Chapter 2 therefore addressed the secondary research objective as identified in 1.5.2(i) which was to analyse the development in the taxation of retirement funds from 1994 to 2024, in order to understand the evolution of the tax treatment. This objective has been satisfactorily addressed by providing a comprehensive overview of the legislative changes and their implications for the taxation of retirement funds.

The current South African tax implications at retirement, withdrawal and withdrawal from the two-pot retirement savings pot will be discussed in the next chapter.

CHAPTER 3: SOUTH AFRICAN INCOME TAX IMPLICATION OF RETIREMENT FUNDS AT EARLY ACCESS OF FUNDS, RETIREMENT OR DEATH AND RESIGNATION

3.1 Introduction

Retirement funds for the purpose of this study includes all pension, provident, pension preservation, provident preservation, and retirement annuity funds. Currently in South Africa, retirement funds savings can be accessed at retirement, resignation and at death of the member. However effective 1 September 2024, members will be able to access a portion of their retirement savings through the two-pot retirement system without having to retire or resign as explained in Chapter 2.

The tax treatment of funds received from retirement funds differs between retirement or death and resignation. SARS imposes tax on resignation at a higher rate as the government discourages people resigning as they tend to deplete the funds before the actual retirement whilst on the other hand, tax imposed on retirement lump sums is more favourable. The retirement fund will obtain a tax directive from SARS to determine the amount of employee's tax to withhold from the lump sum before paying it over member (Stiglingh *et al.*, 2024).

In this chapter, the secondary objective as identified in par 1.5.2(ii) is addressed by analysing the tax treatment of retirement funds at early access, retirement and resignation. The tax treatment in instances where the member dies before retirement will also be analysed.

The next section deals with the analysis of retirement fund contributions in South Africa and aims to clarify how the contributions affect the taxable income of the member through deductions.

3.2 Treatment of monthly contributions to a retirement fund of employed natural persons

Over the member's period of employment, members contribute monthly towards their retirement fund to save for retirement. The member gets a savings from income tax by means of a monthly deduction from their salary or just their contributions paid over to the retirement fund (section 11F of the ITA). Some employers also contribute towards the employee's retirement fund on their behalf. A clear distinction between a pension, provident fund and retirement annuity fund is that a member can only join a pension and provident fund through the employer whereas a retirement annuity fund is not linked to employment and the member can choose the fund they want to invest in (10X, 2024). In a retirement annuity fund, the member makes monthly contributions normally through a debit order which is completely independent from the employer (Old Mutual, 2021). Before 1 March 2021, the difference between a provident and pension fund was that provident fund members could take the entire retirement savings as lump sum whereas pension fund members could only take one third as a lump sum and the remaining would be used to purchase

an annuity provided the *de minimis* rule did not apply (10X, 2024). However, pension and provident funds are now the same as legislation was amended to harmonize them as indicated in Chapter 2.7.

In instances where the employer contributes towards the employee's pension and provident fund, the employer's contribution will be treated as a taxable fringe benefit in the hands of the employee in terms of paragraph 12D of the Seventh Schedule of the ITA. Such contributions are deemed to have been made by the employee in terms of section 11F(4)(a) of the ITA as they are included in the employee's gross income in terms of special inclusion paragraph (i) of the gross income definition (section 1 of the ITA). However, employer's contributions to retirement annuity funds are treated as a taxable benefit in the hands of the employee in terms of paragraph 13 of the Seventh Schedule of the ITA as a settlement of employee debt. This is because the retirement annuity fund is not linked to the services the employee renders to the employer. However, the employer's contribution will be deemed to be made by the employee in terms of section 11F(4)(b) of the ITA.

All contributions made by the employee towards a pension, provident and retirement annuity fund together with the employer's contributions that were treated as a taxable benefit and referred to as 'deemed contributions' will qualify for a deduction against the employees' income when determining the taxable income in terms of section 11F of the ITA. Unclaimed contributions that were disallowed as a deduction in the previous years of assessments solely for the reason that it exceeded the maximum amount allowed to be deducted in terms of s11F of the ITA, will be deemed to be a contribution made in the current year. However, disallowed contributions from the prior year will not be deemed to be made in the current year for purposes of calculating the section 11F of ITA deduction

- If such disallowed contribution has been applied as a deduction to calculate the taxable amount of the lump sum benefit in terms of paragraph 5(1)(a) of the Second Schedule of the ITA for retirement benefits or paragraph 6(1)(b)(i) of the Second Schedule of the ITA for withdrawal benefits.
- If such disallowed contribution was claimed as an exemption against qualifying annuities in terms of section 10C of the ITA.

The deduction in respect of contributions made to retirement funds in any year of assessment is calculated as the lesser of a, b, or c below:

a) R350 000

b) 27.5% of the higher of

i) Taxpayers' **remuneration** excluding retirement lump sum benefits, withdrawal benefits and severance benefits.

Or

ii) Taxpayers' **taxable income** excluding retirement lump sum benefits, withdrawal benefits and severance benefits but before the section 11F retirement contributions deduction, section 18A donations deduction and section 6quat(1C) deduction for taxes paid to any government except the South African government (Income Tax Act of 1962).

c) Taxpayers' **taxable income** including any taxable capital gains but excluding retirement lump sum benefits, withdrawal benefits and severance benefits but before the section 11F of the ITA retirement contributions deduction, section 18A of the ITA donations deduction and section 6quat(1C) of the ITA deduction for taxes paid to any government except the South African government. (Income Tax Act of 1962).

However, the above deduction will be limited to the total contributions that consists of the actual contributions (employee's contribution); 'deemed contributions' (employers' contribution) and the unclaimed contribution disallowed as a deduction in the prior year and that are not prohibited by section 11F(3) of the ITA. Any amount of the total contributions that exceed the maximum deduction allowed, which is the lesser of a, b, or c above, will be carried forward to the next years of assessment. The unclaimed contributions can be used as a deduction in the following order in the next year of assessment (section 11F(3)):

- Deducted against the retirement and withdrawal lump sum benefits in terms of paragraph 5 and 6 of the Second Schedule of the ITA respectively.
- A section 10C of the ITA deduction against the two third of the retirement interest paid out in a form of an annuity.
- Any unapplied amounts after taking into account the above will be deemed to be current year contributions for purposes of calculating a section 11F of ITA deduction (Stiglingh *et al.*, 2024).

According to Lotter and Andrew (2017) the National Treasury was successful in harmonising the tax treatment of contributions to the different funds which in turn limits the wealthy from excessively benefiting from the deduction (Lotter & Andrew, 2017). The new amended legislation that included the harmonisation of retirement funds had an impact in increasing retirement savings and the adopted uniform contribution model showed higher retirement savings due to increased tax deductions leading to a better income replacement ratio upon retirement (Hirschbeck, 2014).

Based on the above, the ability to deduct the contributions is beneficial for the individuals as it reduces the tax liability and increases the disposable income therefore providing incentive for individuals to save more for their retirement.

The tax implications of benefits payable to an individual at retirement will be discussed next.

3.3 Implications of benefits payable at retirement from a retirement fund

When a member reaches retirement age, the member will be entitled to their retirement benefits. Retirement age is set by the rules of the specific fund that the member belongs to. This is because there is no set retirement age prescribed by the law in South Africa (Loubser, 2022). However, a member may retire before the date set by the fund if the member becomes permanently incapable of carrying out their duties because of a sickness, accident, injury or incapacity through infirmity of mind (Momentum, 2021).

At retirement, members of all retirement funds are required to take out a maximum of one third of the retirement savings as a lump sum in cash (Sanlam, 2019). The remaining two thirds of the retirement savings is paid out in a form of a monthly living annuity to the member (Sanlam, 2019). However, should the member's total retirement interest at retirement be less than R247 500, the member must take out 100% of the retirement interest as a lump sum (Sanlam, 2019). The lump sum benefit received by the member at retirement, after deducting paragraph 5 deductions of the Second Schedule of the ITA, will be included in the members gross income in terms of paragraph (e) of the gross income definition (section 1 of the ITA). The following amounts are allowed to be deducted from the retirement lump sum benefit to determine the amount to be included in the gross income paragraph (e) (section 1 of the ITA) (Stiglingh *et al.*, 2024):

- a. Any retirement fund contributions that did not rank as a deduction in terms of section 11F of the ITA.
- b. Amounts transferred to a fund because of an election made after a divorce order.
- c. A transfer previously made from one fund to another for the benefit of the member and the member was previously taxed on the transfer.
- d. A transfer to any preservation fund of an already taxed unclaimed benefit.
- e. The pre-1 March 1998 exemption portion of public sector funds paid into any other fund.

The normal tax payable on retirement lump sum benefits after deducting the above allowable deductions will be calculated by applying the below separate tax table:

Table 3-1: Tax table for retirement lump sum benefits (South Africa)

Taxable income from lump sum benefits	Rate of tax
1 – 550 000	0% of taxable income
550 001 – 770 000	18% of taxable income above 550 000
770 001 – 1 155 000	39 600 + 27% of taxable income above 770 000
1 155 001 and above	143 550 + 36% of taxable income above 1 155 000

Source: SARS (2024)

The first R550 000 of the taxable income will be tax free (SARS, 2024). Thereafter, the amounts will be taxed using a sliding scale based on the brackets that the taxable income from lump sum benefits falls in as indicated in the above table. However, it is important to note that the above tax table follows a cumulative principle that considers all the lump sum benefits of both retirement, severance benefits and withdrawals previously received by the member (Personal Tax Services, 2024). The tax on the retirement lump sum benefit will be calculated as follows using the cumulative principle (SARS, 2024):

- “The tax determined, per the retirement table, by the application of the tax table to the aggregate of the current retirement lump sum/s, plus all other retirement fund lump sum benefits accruing from October 2007, all retirement fund lump sum withdrawal benefits accruing from March 2009, and all other severance benefits accruing from 1 March 2011”

Less

- “The tax determined, per the retirement table, by the application of the tax table to the aggregate of all retirement fund lump sum withdrawal benefits accruing from October 2007 without adding the current retirement benefit, all retirement fund lump sum withdrawal benefits accruing from March 2009, and all severance benefits accruing from March 2011”.

The two thirds portion of the retirement savings that is paid out as a living annuity will also be included in the taxpayer’s gross income in terms of paragraph (a) of the gross income definition as defined in section 1 of the ITA. The annuities will be subject to employees’ tax which is determined according to the normal income tax tables and the provisions of the Fourth Schedule of the ITA.

The South African government encourages individuals to save up their retirement benefits and only withdraw when they reach retirement age. This is done by providing a tax incentive of exempting the first R550 000 of the retirement benefit from tax if a natural person waits till

retirement. The incentive is part of the government's broad effort to ensure that individuals have sufficient funds saved for their retirement rather than relying on the government for state grants (National Treasury, 2021b).

The tax implications of benefits payable to beneficiaries at death of a member of a retirement fund will be discussed next. This contributes to the objective of the study by addressing the secondary objective which involves analysing the tax treatment at death of a member before retirement.

3.4 Implication of retirement benefits payable at death

Where a member dies before reaching retirement age, the lump sum benefit is deemed to accrue to the member the day before the member's death and will be included in the gross income of the deceased in terms of special inclusion paragraph (e) (section 1 of the ITA) (Stiglingh *et al.*, 2024). The death benefit will be paid over to the beneficiaries of the member as elected by the member before death in terms of the retirement agreement (Sanlam, 2019). The consequence of this is that the deceased is taxed and not the beneficiary. However, the tax payable on the death benefit may be recoverable from the beneficiary by the executor of the deceased's estate (Stiglingh *et al.*, 2024). The death benefit will be deemed not to accrue to the deceased member at death if the dependant of the deceased elects to receive a living annuity or the death benefit is paid into a preservation fund as an unclaimed benefit (Stiglingh *et al.*, 2024). Therefore, the beneficiary will be taxed should they receive the death benefit in a form of an annuity in terms of paragraph (a) special inclusion in the gross income definition (section 1 of the ITA).

There are instances where a member who had retired and was receiving monthly living annuities dies, and the beneficiary is entitled to continue receiving the living annuities. Should the beneficiary commute the living annuity to a lump sum, such lump sum will be deemed to be received by the deceased at death and therefore will be taxed in the hands of the deceased as a retirement lump sum benefit (Stiglingh *et al.*, 2024). However, should the beneficiary not commute the annuity for a lump sum, the benefits will be taxed in the hands of the beneficiary (Stiglingh *et al.*, 2024).

The normal tax on death benefits is calculated using the same tax table as retirement lump sum benefit as indicated above in 3.3 in Tabel 3-1. Death benefits from any funds are governed by the Pensions Fund Act and are not considered property in the deceased estate for estate duty purposes in terms of section 3(2)(i) of the Estate Duty Act 45 of 1955 (Collier, 2022).

In conclusion, the tax implications of death benefits from retirement funds in South Africa ensure that the tax liability is either borne by the deceased's estate or the beneficiaries, depending on the form in which the benefit is received.

The tax implications of benefits payable to individuals who resign and cash out from their retirement funds will be discussed next.

3.5 Implications of benefits payable at withdrawal/resignation

In terms of section 1 of the ITA, a retirement lump sum withdrawal benefit is defined as any amount assigned in terms of a divorce order, a transfer for the benefit of the member from a fund which the member is or was a member to another fund and lump sum amounts received or accrued to the member from withdrawal of a fund. When a member withdraws from the retirement fund before reaching retirement age, the member will be entitled to receive the full value of their retirement savings as a lump sum in cash if the resignation and withdrawal happened before 1 September 2024. Lump sum withdrawal benefits are taxed at a higher rate compared to retirement benefits as a way to discourage people from resigning and withdrawing from their funds as this depletes their retirements benefits before, they reach retirement age (National Treasury, 2021b).

The lump sum benefit received by the member at withdrawal after deducting paragraph 6 deductions of the Second Schedule of the ITA will be included in the members gross income in terms of paragraph (e) of the gross income definition (section 1 of the ITA). The following amounts are allowed to be deducted from the withdrawal lump sum benefit to determine the amount to be included in the gross income (section 1 of the ITA; paragraph 6 of the Second Schedule of the ITA):

- a. Any retirement fund contributions that did not rank as a deduction in terms of section 11F of the ITA.
- b. Amounts transferred to a fund because of an election made after a divorce order.
- c. A transfer previously made from one fund to another for the benefit of the member and the member was previously taxed on the transfer.
- d. A transfer to any preservation fund of an already taxed unclaimed benefit.
- e. The pre-1 March 1998 exemption portion of public sector funds paid into any other fund.

The normal tax payable on withdrawal lump sum benefit after deducting the above allowable deductions will be calculated by applying the below separate tax table:

Table 3-2: Tax table for withdrawal lump sum benefits (South Africa)

Taxable income from lump sum benefits	Rate of tax

1 – 27 500	0% of taxable income
27 501 – 726 000	18% of taxable income above 27 500
726 001 – 1 089 000	125 730 + 27% of taxable income above 726 000
1 089 001 and above	223 740 + 36% of taxable income above 1 089 000

Source: SARS (2024)

The first R27 500 of the taxable income will be tax free. This is very low compared to the tax-free portion of retirement lump sum benefits that is R550 000. The amounts will be taxed using a sliding scale based on the brackets that the taxable income from lump sum benefits falls in as indicated in the above table. The above tax table follows a cumulative principle and the tax on the withdrawal benefit will be calculated using the cumulative principle as follows (SARS, 2024):

- “The tax determined by the application of the tax table to the aggregate of the current withdrawal lump sum, plus all other retirement fund lump sum withdrawal benefits accruing from March 2009, all retirement fund lump sum benefits accruing from October 2007, and all severance benefits accruing from March 2011”

Less

- “The tax determined by the application of the tax table to the aggregate of all retirement fund lump sum withdrawal benefits accruing from March 2009 without adding the current withdrawal benefit, all retirement fund lump sum benefits accruing from October 2007, and all severance benefits accruing from March 2011”.

Members who resign from employment or lose their jobs can transfer their retirement savings to a preservation fund to preserve their savings until they retire or transfer to the new employer’s fund rather than being exposed to a high tax should they decide to also withdraw from the retirement fund (Momentum, 2019). This transfer will result in no income tax (paragraph 2 of the Second Schedule of the ITA).

In conclusion, the tax implications for lump sum withdrawal benefits were designed to discourage people from cashing out their savings at resignation by imposing higher tax rates compared that of retirement benefits. However, statistics show that despite the punitive tax rates, the discouraged behaviour of withdrawing retirement benefits before reaching retirement age is not minimising (National Treasury, 2021b). With the implementation of the two-pot retirement system, the number of withdrawals is expected to drop as individuals will have access to a part of their

benefits in case of emergencies therefore not necessitating the need to resign and cash out the benefits.

The tax implications of benefits payable to members of public sector funds will be discussed next.

3.6 Implications of benefits payable to members of public sector funds

The lump sum benefit amount to be included in the members gross income in terms of paragraph (e) of the gross income definition (section 1 of the ITA) for public sector fund members is determined in terms of a formula in paragraph 2A of the Second Schedule of the ITA which is different from other retirement funds. GEPF is the largest public sector fund in South Africa with over 1,2 million active members (GEPF, 2024). As lump sum benefits from public sector funds were subject to tax effective 1 March 1998, all retirement savings accrued before the effective date are tax free. The amount calculated by the formula in paragraph 2A of the Second Schedule of the ITA is deemed to be the actual lump sum benefit received for tax purposes. The formula is as follows:

$$A = \frac{B}{C} \times D$$

Where:

A = The deemed lump sum benefit.

B = The number of years completed of service after 1 March 1998.

C.= The total number of completed years of service.

D.= The actual lump sum benefit.

The outcome of the above formula is to separate the lump sum benefit between the tax-free portion which is the portion attributable to 1 March 1998 and the portion subject to tax (paragraph 2A of the Second Schedule of the ITA). The amount determined by the above formula A is deemed to be the lump sum benefit and qualifies for deductions in terms of paragraph 5 for retirement benefits and paragraph 6 for withdrawal benefits of the Second Schedule of the ITA.

For retirement benefits, the deemed lump sum as calculated by the above formula A less paragraph 5 deductions of Second Schedule of ITA will be included in the gross income paragraph (e) (section 1 of the ITA) of the taxpayer and the income tax will be calculated using Table 3-1: Tax table for retirement lump sum benefits.

For withdrawal benefits, the deemed lump sum as calculated by the above formula A less paragraph 6 deductions of Second Schedule of ITA will be included in the gross income paragraph

(e) (section 1 of the ITA) of the taxpayer and the income tax will be calculated using Table 3-2: Tax table for withdrawal lump sum benefits.

In conclusion, the tax treatment of lump sum benefits for public sector fund members, using the formula in paragraph 2A of the Second Schedule of the ITA, ensures that only the portion of benefits accrued after 1 March 1998 is subject to tax. This tax treatment differs from non-public sector funds because, before 1 March 1998, public sector funds were not subject to tax. Therefore, the formula effectively splits the tax-free portion (the retirement interest accrued before 1 March 1998) from the taxable portion, ensuring an equitable and accurate tax calculation.

The tax implications of benefits payable to individuals who access their retirement benefits early through the two-pot retirement system will be discussed next.

3.7 Tax treatment of the two-pot retirement system

As discussed, above in Chapter 2.8, effective 1 September 2024, retirement funds are divided into two separate pots: the savings pot for limited early access and the retirement pot for preservation until retirement. The tax treatment differs between the retirement pot and the savings pot (National Treasury, 2021b). Extensive consultations were held by the National treasury together with SARS to determine an effective way of determining the tax treatment of the withdrawal from the savings pot without being prejudicial to the taxpayer (National Treasury, 2021b). The proposed tax implications of the two-pot retirement system that were being considered together with the adopted treatment will be discussed next.

3.7.1 Proposed tax treatments

The National Treasury investigated potential tax treatments for the savings pot using international designs as a base. The proposals that were formulated will be considered below (National Treasury, 2021b):

3.7.1.1 Include the withdrawal from the savings pot in the taxable income in the year of withdrawal

Withdrawals from the savings pot will be included in the member's normal taxable income and will be subject to the normal tax tables at a marginal rate (National Treasury, 2021b). This tax treatment will limit potential tax arbitrage as the individual would have received a deduction of the contribution in the same year whereafter the withdrawal will be included back into the taxable income for the year (National Treasury, 2021b). This tax treatment would discourage large withdrawals from the savings pot as they will be taxed at a higher marginal rate. This approach will however create problems for retirement funds as they will not have all the employee data like other earnings to calculate the correct employees' tax to withhold from the withdrawal unlike in

the current system where a SARS tax directive determines the exact amount (National Treasury, 2021b). This will potentially lead to unexpected tax bills or refunds for the taxpayer during the filing season (National Treasury, 2021b).

3.7.1.2 Switching the application of tax from withdrawals to contributions for the savings pot

The proposed tax system involves taxing contributions and growth from investment but exempt benefits at withdrawal which effectively creates a tax-free savings account within a retirement fund. In this system, there will not be a need for retirement funds to obtain a directive from SARS as the withdrawals won't be subject to withholding tax (National Treasury, 2021b). This system would eliminate tax arbitrage and the issue on differences in the effective tax rates between low- and high-income earners (National Treasury, 2021b).

3.7.1.3 Moving to a flat deduction percentage for contributions

This proposal suggested a flat deduction on contributions wherein the deduction is not related to the income and creates more benefit for the low-income tax brackets (National Treasury, 2021b). It also proposed that tax on withdrawals from the two-pot retirement system be taxed at a same flat rate which eliminated the need for retirement funds to obtain tax directives and avoid unexpected tax liabilities or refunds for taxpayers (National Treasury, 2021b).

3.7.1.4 Keep the current tax system

Under the current tax system, withdrawals from the savings pot would be taxed according to the tax table for withdrawal lump sum benefits as discussed in section 3.5 above.

In conclusion, the National Treasury explored the above proposed tax treatments that were based on international designs of OECD member countries and questions were published to the public consultation process. After taking into account comments from different stakeholders and the public consultation, the tax treatment discussed below was adopted.

3.8 Adopted tax treatment

On 1 June 2024, the President of South Africa, Mr Cyril Ramaphosa, signed into law the Revenue Laws Amendment Bill of 2023 which formally brought the two-pot retirement system into effect from 1 September 2024. The tax treatment that was adopted is discussed below.

3.8.1 Withdrawals from the savings pot

The withdrawals from the savings pot will be included in the member's gross income in terms of paragraph (eD) of the gross income definition (section 1 of the ITA) which will be taxed using the

marginal tax rates in terms of the normal tax tables. This means that the withdrawals will not be taxed using the withdrawal tax table as depicted in section 3.5 above which would create a tax arbitrage. Tax arbitrage is created when the tax saved through the contribution deduction would be greater than the withdrawal from the savings pot as the amount is limited to R30 000 for the first year of assessment (National Treasury, 2021b). The application of the normal tax tables will not result in a higher tax liability for the taxpayer as the normal tax tables are lower than the tax rates on the retirement withdrawal lump sum tax table (Investec, 2024b). At retirement, members can take any balance in the savings pot in cash, and they will be taxed using the retirement lump sum table as depicted in section 3.3 above (Investec, 2024a). However, should a member exit the fund by means of resignation, the member will receive 100% of the savings pot in the form of a withdrawal lump sum and such lump sum benefit will be taxed using the withdrawal tax tables as depicted in section 3.5 above (Investec, 2024a).

Concerns are raised over the sufficiency and adequacy of the R30 000 in the parliamentary committees. According to Karidza (2024), the Head of Actuarial and Benefits Administration at GEPPF, the R30 000 withdrawal limit should be viewed as first step towards addressing the debt as the amount was enough.

According to Duvenhage (2024), whilst the two-pot retirement system will provide immediate financial relief, it undermines long-term retirement security. It was suggested that policymakers must consult the pension systems of the Netherlands, Iceland, Denmark, and Israel to obtain an understanding of how adequacy and sustainability are prioritised, as a lot still needed to be thought about regarding the two-pot retirement system (Duvenhage, 2024). Based on Duvenhage's (2024) view, people should be cautious about withdrawing from the two-pot retirement system, as it provides short-term relief but risks reducing long-term retirement security and eroding future financial stability (Duvenhage, 2024).

3.8.2 Vested component

The vested component will include all retirement contributions including growth that a member has accumulated prior to the implementation date (1 September 2024). The tax implications will depend on the mode of exit which is either retirement or resignation. At retirement, only one third of the vested component will be paid out in cash as a lump sum and subject to the tax in terms of the tax table for retirement lump sum benefits as depicted in section 3.3 above and the remaining two thirds will be paid out in a form of a living annuity subject to normal tax and the *de minimis* rule (Bechard, 2024). Should a member choose to withdraw from the fund before retirement, they will obtain 100% of the savings and growth in the vested component in the form of a lump sum. The withdrawal benefit will be taxed using the tax table for withdrawal lump sum benefits as depicted in section 3.5 above (Bechard, 2024).

The vested rights of the funds before 1 September 2024 will remain intact, and members can still access the funds and be taxed the same way it was before the implementation of the two-pot retirement system.

3.8.3 Retirement pot

At retirement, death, or retrenchment, 100% of the retirement pot will be paid out in the form of an annuity subject to the de minimis rule discussed above in Chapter 2.7. The annuities will be included in the gross income in terms of paragraph (a) (section 1 of the ITA) of the taxpayer and taxed using the marginal tax rates in the normal tax tables. Should the total value of the retirement pot be less than R165 000 at retirement, the amount will be received by the member in cash as a lump sum, be included in gross income in terms of paragraph (e) (section 1 of the ITA) and taxed in terms of the retirement tables (Table 3-1 in 3.3 of this research) (Investec, 2024b). At death of the member, the beneficiary will receive payments in the form of an annuity and such annuities will be taxable in the hands of the beneficiary (GEPF, 2024).

3.9 Conclusion

The research objective addressed in chapter 3 was to analyse the tax treatment of retirement funds in South Africa at early access due to the two-pot retirement system, retirement, resignation and death. This objective was successfully achieved as this chapter has extensively discussed the normal tax implications related to retirement funds in South Africa, covering various stages of engagement such as contributions, early access, retirement, resignation, and death. It also discusses how public sector funds are taxed. The chapter further introduces the enacted two-pot retirement system, which changes how retirement savings can be accessed and examines the tax treatments for each scenario.

As retirement fund taxation evolves, especially with the two-pot retirement system that became effective on 1 September 2024, it's crucial for members to stay informed of the tax treatments of the different type of events triggering pay outs of retirement savings. The introduction of the two-pot retirement system means that members who join retirement funds after 1 September 2024 will no longer receive a lump sum at retirement if they withdraw all their savings pot before retirement, potentially leaving them financially vulnerable at retirement.

In conclusion, this chapter has analysed the tax treatment of South African retirement funds which is critical for the broader research topic that aims to compare the tax treatment of South African retirement funds to that of other selected countries internationally. This analysis contributes to the main objective of benchmarking South Africa's tax provisions against those of the selected international countries with the ultimate goal of identifying areas for possible recommendations, which follows in the next chapter.

CHAPTER 4: COMPARISON AND ANALYSIS BETWEEN THE INCOME TAX IN SOUTH AFRICA AND THE INCOME TAX IN SELECTED DEVELOPED COUNTRIES

4.1 Introduction

With statistics showing an outflux of South African citizens to foreign countries to seek better opportunities, it is important to consider how the tax treatment of retirement funds in these countries compares to that of South Africa to better assist emigrating individuals, so they make informed decisions.

Understanding the tax treatment of retirement funds across the selected different countries provide an insight on how the different countries approach retirement savings. The main aim of this chapter of the study is to compare the income tax implications of retirement funds of the selected countries.

This chapter provides an analysis of the tax treatment of retirement funds at early access, resignation, retirement and death of Australia, Canada, the UK, and the USA. Refer to Chapter 1.3 for the reasons the countries were selected. The income tax implications of the selected countries will be analysed with the aim of determining how the tax treatment differs or is similar to that of South Africa. This will be achieved by analysing the income tax acts and revenue codes of Australia, Canada, the UK, and the USA then compare it to the South African income tax treatment highlighted in Chapter 3. An in-depth study of the legislations of the selected foreign countries is beyond the scope of this research. However, tax legislation is based on the publications found and the conclusions will be based on the basic principles. This chapter therefore addresses the secondary research objectives as shown in par 1.5.2(iii) and par 1.5.2(iv).

The next section of the chapter will discuss the background and tax implications of retirement in Australia.

4.2 Australia

4.2.1 Background

In Australia, retirement funds are commonly known as superannuation funds, or simply super. Superannuation funds are mandatory for all employees either full time or part time as well as casual workers in Australia as part of a system implemented by the Australian government to help citizens save for their retirement (Australian Government, 2024). Employers are required to pay the super guarantee at least four times a year. The super guarantee charge is the minimum amount employers must pay to provide for the employee's contribution (Australian Government, 2024).

The minimum amount the employer must contribute is currently 11.5% of the employee's base earnings and will increase to 12% in 2025 (Australian Government, 2024). However, employers may choose to contribute more than the minimum rate and employees may make voluntary contributions themselves which increases their retirement savings. Ralston and Feng (2017) found that the increase to 12% in 2025 will be of critical importance as the majority of the lower- and middle-class people are not in a position to make voluntary contributions.

There are several types of superannuation funds, each catering to different needs of the employees, namely the retail, industry, public sector, corporate and self-managed super funds (Moneysmart, 2024a). Retail superannuation funds are offered by banks and investment companies and are accessible to anyone, often featuring a wide range of investment options (Moneysmart, 2024a). Industry super funds are tailored for employees in specific industries, are now generally open to the public and are typically non-profit, managed by a combination of employer associations and unions (Moneysmart, 2024a). Public sector funds are only accessible to government employees and may offer defined benefit or accumulation plans. Corporate super funds are established by employers for their employees, with some managed internally and others by external fund managers (Moneysmart, 2024a). Lastly, self-managed super funds allow individuals to take direct control of their retirement investments.

Supers are taxed at three points in their life cycle, namely on contribution, accumulation phase and on withdrawal, which are discussed below. To withdraw money from the super, the employee should have satisfied the condition of release. The condition of release is when the person reaches age 65, reach preservation age and retire or satisfy an early access requirement (Australian Tax Office, 2024). Retirement is defined as when the employee is 60 years or older or when below the age of 60 but has reached preservation age and has no intention of being employed again (Australian Tax Office, 2024). Preservation age is the date at which a person can access their super or start a transition to a retirement income stream should you intend to work in future (Australian Tax Office, 2024). The preservation age is between 55 and 60 and it depends on the employee's date of birth. The three-points life cycle of a super will be discussed next.

4.2.2 Three-points life cycle of a super

4.2.2.1 Contributions

The tax paid on contributions depends on whether the contributions are made from the prior or post tax income, whether the employee is a high-income earner and whether the contribution caps are exceeded. High income earners are individuals whose income and concessional contributions exceed \$250 000 (Australian Tax Office, 2024).

Before tax contribution, also known as concessional contributions, are contributions wherein no tax has been paid at the time of contribution, and these include the compulsory employer super guarantee contribution and salary sacrificed contributions (Australian Tax Office, 2024). The concessional contributions are taxed at a concessional rate of 15% which is payable by the fund. Employees who make personal contributions to the super will be entitled to an income tax deduction on the contribution, provided that they give the super fund a notice of intent that they will claim a deduction and receive acknowledgement from the superfund (Australian Tax Office, 2024). If the employee's combined income and concessional contributions exceed \$250 000, an additional tax called a Division 293 tax will be charged at 15% of the lesser of the excess over the threshold or taxable super contributions (Australian Tax Office, 2024).

Post tax contribution, also known as non-concessional contributions, are contributions made by the employer out of the employee's after-tax income (Australian Tax Office, 2024). No contributions tax is payable on non-concessional contributions as income tax has already been paid (Moneysmart, 2024b).

In summary, super contributions in Australia depend on whether they are made before or after tax, with concessional contributions taxed at 15% and high-income earners possibly facing an additional Division 293 tax for exceeding the thresholds, whilst non-concessional contributions are not subject to tax. The South African system does not distinguish between pre- and post-tax contributions and all contributions are deductible up to certain limits.

4.2.2.2 Investment earnings

The superannuation contributions are invested over the working period of the employee until they reach their retirement age, and the investment earns a return. The investment earnings or growth of the contributions are taxed at a flat rate of 15% and the tax is paid over to the revenue authority by the superannuation fund (Moneysmart, 2024b). The above indicates that the Australian funds are taxed on the investment income earned on the contributions invested and are therefore not tax-free earnings when compared to South Africa that exempts the investment income within the funds.

4.2.2.3 Withdrawal of the super

The employee can choose how they wish to receive their retirement savings, either as a super income stream or a lump sum and the tax differs between the two options that will be discussed in more detail under 4.2.4 (BT, 2024). The tax also depends on whether the money in the super is tax-free or taxable and the amounts exceed the caps and the age of employee. The super consists of the tax-free and taxable portions. The tax-free portion consists of the non-concessional contributions including the employee's personal after-tax contributions provided that they were

not allowed as a tax deduction against the income tax (BT, 2024). On the other hand, the taxable portion of the super includes the concessional contributions made by the employer or salary sacrifices (BT, 2024). The taxable portion will have two elements, which is the taxed element which is the portion of the super fund paid tax on, and the untaxed element which is the portion of the super fund that no tax was paid on, and mostly common in a public sector fund (Australian Tax Office, 2024). Generally, the super benefits include both the tax free and taxable portion and at retirement the super fund will calculate a split of the two amounts.

In conclusion, as seen from the above, the three-points life cycle of a super involves the contribution, investment earnings and withdrawal stages. Contributions are taxed depending on whether they are concessional or non-concessional whilst investment earnings are taxed at 15%, which makes them not tax-free. Finally, the tax on withdrawals depends on the tax status of the contributions, the age and whether they are taxable or tax-free portions.

Next, the rules pertaining to early access to retirement funds in Australia will be discussed, as this will be used later in the chapter to perform a comparison with the rules of South Africa. This is relevant as it is essential for a broader analysis, highlighting the differences and similarities and tax implications between South Africa and Australia.

4.2.3 Early access

An employee is considered to have withdrawn from the super fund where they access their super benefits before reaching preservation age. This is considered to be an illegal access to the super as the condition of release has not been met, which is reaching preservation age (Australian Tax Office, 2024). Employees will face additional income tax, tax shortfall penalties and interest. Where the employee illegally accessed the super before the condition of release is met, the entire amount of the super benefit is taxable regardless of whether there is a tax-free component (Australian Tax Office, 2024). The amount will be treated as income and will be included in the employee's tax return and the tax will be calculated using the marginal tax rate (smsfwarehouse, 2024).

In other words, it is not allowed for employees to withdraw from their super funds before reaching the condition of release. However, there are limited circumstances where an individual can legally access their super funds early. This includes access on compassionate grounds, due to a terminal medical condition, severe financial hardship, or temporary and permanent incapacity (Australian Tax Office, 2024).

4.2.4 Tax implications at withdrawal

This section examines the tax implications of withdrawal from a super, considering the age of the individual, whether the amount is a taxed element or untaxed element and whether the super is withdrawn as a lump sum or income stream. The discussion focuses on the tax implications of the different age groups namely individuals below preservation age, individuals between 55 and 60 years and individuals above 60 years as the implications differ according to age together with the tax-free portion of the super.

4.2.4.1 Tax-free portion

The tax-free portion remains untaxed regardless of whether the benefit is taken as a lump sum or as an income stream. However, tax may be payable on the tax-free component where a person is in receipt of a death benefit capped defined benefit income stream where the deceased was 60 years or above at time of death or where the member exceeds the defined benefit income cap (Australian Tax Office, 2024). The entire amount of the tax-free super benefit is taxable if an individual accesses their super before meeting the minimum condition of release discussed in 4.2.1 (Australian Tax Office, 2024).

4.2.4.2 Individual below the preservation age

The taxable component of the super of an individual below the preservation age (age between 55 and 60 years depending on the individuals birth date) will be taxed as set out in Table 4-1 below:

Table 4-1: Tax implications for individuals below preservation age (Australia)

Type of taxable component	Withdrawal type	Tax rate
Taxed element	Income stream	Taxed at the employee's marginal tax rate. The employees also qualify for a 15% tax offset if the super benefit is received as a disability income stream.
Taxed element	Lump sum	Lower of 22% or the employee's marginal tax rate.
Untaxed element	Income stream	Taxed at the employee's marginal tax rate.
Untaxed element	Lump sum	Lower of 32% or the employee's marginal tax rate, unless the sum of all untaxed elements of the super

		benefits exceeds \$1 650 000, then the amount above \$1 650 000 will be taxed a marginal rate of 47%.
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Source: Australian Tax Office (2024)

Table 4-1 above outlines the tax rates applicable to the different components of super withdrawals distinguishing between taxed and untaxed elements of the super. A significant marginal rate is used on larger untaxed lump sums which may deter individuals from accumulating excessive untaxed amounts to avoid substantial tax burdens.

4.2.4.3 Individual is between the preservation age and 60 years

The taxable component of the super payment will be included as assessed income when calculating the tax liability in the tax return. The tax rate to be applied on the super payment will be determined depending on the type of withdrawal, and whether the amount is below or above the lower rate cap amount. A lower rate cap applies to persons who reach preservation age but are below the age of 60 (Australian Tax Office, 2024). The lower rate cap is a limit that taxable elements of the super, both taxed and untaxed, must reach in order to be taxed at a lower rate of tax (Australian Tax Office, 2024). Should the amount of the super exceed the cap, the amounts will be taxed at a higher rate. The lower rate cap is currently \$235 000 for the 2023–2024 tax years (Moneysmart, 2024b). The tax on the super is calculated as set out in Table 4-2 below (Australian Tax Office, 2024).

Table 4-2: Tax implications for individuals between individuals' preservation age and 60 years (Australia)

Type of taxable component	Withdrawal type	Effective tax rate up to low-rate cap	Effective tax rate above low-rate cap
Taxed element	Income stream	Taxed at the employee's marginal tax rate. The employees also qualify for a 15% tax offset.	Taxed at the employee's marginal tax rate. The employees also qualify for a 15% tax offset.
Taxed element	Lump sum	0%	Taxed at the lower of the marginal rate or 17%

Untaxed element	Income stream	Taxed at the employee's marginal tax rate.	Taxed at the employee's marginal tax rate.
Untaxed element	Lump sum	Taxed at the lower of the marginal rate or 17%	Lower of 32% or the employee's marginal tax rate unless the sum of all untaxed elements of the super benefits exceeds \$1 780 000 for 2024-2025, then the amount above \$1 780 000 will be taxed a marginal rate of 47%.

Source: Australian Tax Office (2024)

As seen from Table 4-2 above, for individuals who are between preservation age and 60 years, the tax rates differ depending on whether the withdrawal amount exceeds the low-rate cap or not. When comparing the lower- rate cap tax implications and the above low-rate cap, the tax rates are more or less the same as they both take into account the marginal tax rate, however the lump sum withdrawals are more beneficial at the lower rate as it attracts tax at zero percent. Similarly to the individuals below preservation age, a significant marginal rate is applied on large untaxed element lump sums.

4.2.4.4 Individuals who are 60 years or older

For individuals 60 years and older, no tax is paid on the tax-free component and taxed element of the taxable component of the super irrespective of whether it's received as a lump sum or an income stream (Australian Tax Office, 2024). The tax-free portion where the super is paid out in the form of an income stream will be included in the member's assessable income provided that the total tax-free component and taxed element is in excess of the defined benefit cap (Australian Tax Office, 2024). The untaxed element of the taxable portion will be taxed using the taxpayer's marginal rate where the super benefit is received in the form of an income stream (Australian Tax Office, 2024). However, should the member opt to receive the benefit in the form of a lump sum, the tax payable on the super will be the lesser of the marginal rate or 17% unless the sum of all untaxed elements of the super benefits exceeds \$1 780 000 for 2024-2025, then the amount above \$1 780 000 will be taxed a marginal rate of 47% (Australian Tax Office, 2024).

However, members who receive a capped defined benefit income stream will be taxed differently. A capped defined benefit income stream is a lifetime pension that guarantees specific income for life. Where the tax-free component and the taxable component taxed element is below the defined benefit income cap of \$118 750 for 2024-2025, no tax is payable on the super (Australian Tax Office, 2024). However, should it be above the defined benefit cap, 50% of the amount above the

cap is assessed at the marginal taxed rates (Australian Tax Office, 2024). Where the income stream is from the untaxed element of the taxable component, the super will be taxed using the marginal rate (Australian Tax Office, 2024).

In conclusion, as seen from the above discussion, the tax treatment becomes more favourable as an individual's age increases, with individuals above age 60 years enjoying a more favourable tax treatment with tax-free benefits on taxed elements, unlike higher rates that apply to individuals younger than 60 years.

Individuals between preservation age and 60 years enjoy a tax-free lump sum from the taxed element if the withdrawal is below the low-rate cap. Heavier tax is levied on untaxed element lump sums which serves as a way for discouraging individuals of accumulating excessive untaxed super balances.

In the next section, the tax implications of super benefits at death will be discussed which ultimately assists in doing an international comparison of how death benefits are taxed in Australia when compared to that in South Africa.

4.2.5 Tax on death benefits

The tax on a super death benefit depends on whether the amount is paid over to a dependant of the deceased or not. Where the super death benefit is paid over to a dependant of the deceased in a form of a lump sum, no tax will be payable on the super benefit (Australian Tax Office, 2024). Where the benefit is paid in the form of an income stream, no tax is payable if the dependant is over the age of 60. However, should the dependant be over the age of 60 and the benefit relates to an untaxed element of the taxable component, tax at the marginal tax rate will be payable (AustralianSuper, 2024). If the dependant is under the age of 60, tax will be payable on the taxable components of the income at the marginal rates (AustralianSuper, 2024).

Super death benefits can only be paid to non-dependants of the deceased in the form of a lump sum. The taxed element of the taxable component will be taxed at 17% whilst the untaxed element of the taxable component of the super benefit will be taxed at 32% (AustralianSuper, 2024).

In conclusion, the tax treatment depends on the recipient's relationship to the deceased and their age. The Australian tax system can be seen to be more beneficial for dependants of the deceased as portions of the benefit may be tax-free while non-dependants face substantial tax with no tax-free portions.

A comparison of the tax implications between South Africa and Australia will be presented next.

4.2.6 Comparison of Australia to South Africa

As seen from the discussions above, both South Africa and Australia offer a tax incentive on contributions to retirement funds. However, Australia has a mandatory super system with a minimum contribution rate set by the government, while in South Africa it is voluntary with tax deductible limits. In South Africa, contributions are tax deductible up to the lesser of 27,5% of remuneration or taxable income but capped to R350 000 per annum. In Australia on the other hand, contributions to super funds are taxed at 15% and any contributions that exceed a limit will be subject to an additional tax. Employees who make personal super contributions qualify for a tax deduction against their taxable income. In South Africa, any investment growths earned within the retirement funds are exempt from tax. However, in Australia, investment earnings within the super funds are taxed at a flat rate of 15%.

In South Africa, individuals can withdraw up to one third of their retirement savings as a lump sum and the first R550 000 of the lump sum will be tax free based on a progressive tax table. The remaining two thirds will be paid out in an annuity, and this will be taxed using the normal marginal tax tables. In contrast, in Australia, withdrawals from a super for individuals who are 60 years or older are typically tax free and individuals can choose as to whether they are taking the super as a lump sum or an annuity. However, for individuals below the age of 60 years, their benefits will be subject to tax at a flat rate or 0% depending on whether the amount is from the taxed element or untaxed element, withdrawal type and the caps. The Australian super has a tax-free portion which is not subject to tax and the fund must perform a split to determine the tax-free portion and taxable portion of the benefits. Similarly, South Africa also provides tax-free benefits of which the amounts are embedded on the tax tables used to determine the tax.

In Australia, accessing superannuation before the preservation age is generally not permitted except under specific hardship conditions, and such withdrawals are subject to higher tax rates, discouraging early access. South Africa also discourages this by imposing higher taxes and decreasing the tax-free portion to R27 500 and taxing the remaining amount at a progressive tax table. However, with the implementation of the two-pot retirement system, individuals who join retirement funds after 1 September 2024 will not be able to access their retirement pot before reaching retirement. However, they can access their savings pot at least once a year. Based on the above, both South Africa and Australia restrict early withdrawal and impose heavy tax to discourage this.

In conclusion, Australia it seems, has a more favourable tax treatment as retirees benefit from tax-free withdrawals after 60 while South Africans face taxes on both the lump sum and annuities. The Australian system also provides flexibility to individuals as they can decide as to how they will receive their benefits and does not have the mandatory annuitization rules like in South Africa.

The next section of this chapter will discuss the background of retirement funds in Canada together with the tax implications.

4.3 Canada

4.3.1 Introduction

The Canadian retirement system is a multifaceted structure that is designed to provide financial security to its citizens during their retirement years. The Canadian retirement system can broadly be categorized into three main tiers namely, the public pension system, employer sponsored system and individual savings and investments. In the following sections, we will discuss the tax implications focusing on how contributions, investment earnings and withdrawals are treated from an income tax perspective. The Canadian pension plan will be discussed in the next section of the Chapter.

4.3.2 Canada Pension Plan

4.3.2.1 Background

The main program for retirement in Canada is the government administered Canadian Pension Plan (CPP) or the Quebec Pension Plan (QPP) that depends on the location that the individuals work (Cahill, 2020). QPP applies to individuals who work in the Quebec territory whilst the CPP applies to individuals who work in other provinces and territories outside Quebec (Cahill, 2020). Almost all individuals who work either in Quebec or other territories and provinces in Canada either contribute to the QPP or the CPP as they are compulsory for all working Canadians between the age of 18 and 70 who earn more than \$3 500 per year (Drake, 2020).

In the sections that follow, a detailed analysis of the tax treatment of the CPP will be discussed focusing on contributions, retirement withdrawals and death benefits.

4.3.2.2 Contributions

For the 2024 tax year, both the employer and the employee equally contribute 5.95% of the employee's annual gross income from \$3 500 up to a maximum of \$68 500 (Vittoratos, 2024). Individuals who earn more than \$68 500 will be permitted from 2024 to make additional contributions to the CPP, known as a second earnings ceiling, so they can save more towards their retirement. The second earnings ceiling additional contribution will be required for pensionable earnings between the first maximum of \$68,500 and \$73,200 (Vittoratos, 2024).

The contribution rate for these earnings is set at 4%, with a maximum contribution of \$188, which the employer is required to match (Vittoratos, 2024). The employee contribution is tax deductible,

and the employee obtains a tax credit calculated using the lowest tax rate which is a 15% personal tax credit on their portion of the contribution (UBC Finance, 2024).

The CPP was structured in a way that ensures equal participation by both the employer and employee and allowing additional contributions for high income individuals who wish to save more for retirement.

4.3.2.3 Implications at retirement

CPP or QPP are public plans that provide a basic pension to retirees when they reach retirement and the amount to be received at retirement is based on contributions they made and the length of time one has contributed (Drake, 2020). Individuals are eligible to start receiving the CPP when they reach the age of 60 years and have at least made a contribution to the plan (Western U, 2024). However, individuals who are receiving the CPP benefit who are between 60 years and 65 years must continue making contributions to the CPP which is automatically deducted from their CPP benefits (Western U, 2024). Individuals between the ages of 65 years and 70 years may elect to cease contributions by making an application to the Canada Revenue Agency (Western U, 2024). The CPP amount is only payable in the form of a monthly annuity and no CPP amounts are paid out as a lump sum. The amount to be paid depends on the monthly contributions made by the employee and the length of the contributions and such amount will be paid for the rest of the life of the individual.

For 2024, the maximum monthly amount, an individual would receive, if they started receiving the pension at the age of 65 years, is \$1 364.60. Not all individuals receive the maximum benefit as most have not contributed enough over their lifetimes (MacColl, 2024). To qualify for the maximum CPP payout, individuals must have contributed for at least 39 years between the age of 18 years and 65 years (Drake, 2020). The CPP payouts are considered income and subject to federal and provincial income tax at the individual's marginal tax rate that depends on the province which the individual resides in and their total income for the year (MacColl, 2024).

In conclusion from the above, the disbursement of the CPP as an annuity provides sustainable income to retirees and guarantees financial stability throughout their retirement years. However, as the payouts are subject to tax, this reduces the disposable income, and retirees may not have the same income they had before retirement, creating a financial burden for them.

The implications at death of a member will be discussed next.

4.3.2.4 CPP at death

At the death of the member, a once off flat amount of \$2 500 death benefit is paid over to the authorized estate representative who is responsible of administering the estate of the deceased (Drake, 2020). If the deceased does not have a will or estate, the person responsible for paying for the funeral expenses is eligible to apply for and receive the death benefit (Drake, 2020). To qualify for the death benefit, the deceased must have made contributions to the CPP for a minimum of either 10 calendar years or a third of the calendar years in their contributory period, whichever is lesser (Misir, 2024). The death benefit is generally taxable income for the estate or beneficiary depending on who received it (Misir, 2024). However, it is not taxable provided that the amount was used by the recipient for the deceased's funeral costs and the death benefit does not exceed the funeral costs (Misir, 2024).

In conclusion, the above section 4.3.2 analysed the CPP and highlighted the contribution rules, tax implications at retirement and death. The analysis showed that the CPP ensures basic income during the retiree's lifetime while still imposing tax and limits the death benefit to a flat amount which is considered to be sufficient by the government to cover funeral costs. Unlike in South Africa, the CPP death benefit is not designed to enrich the dependants of the deceased but to cover the funeral costs.

The employer sponsored component of the Canadian retirement system will be discussed next.

4.3.3 Employer sponsored plans

4.3.3.1 Background

The Canadian retirement system also includes voluntary schemes which are not administered by government where employers and employees can make additional contributions to supplement the mandatory CPP and these include the Registered Pension Plan (RPP), Registered Retirement Savings Plan (RRSP) and the Tax-Free Savings Account (Cahill, 2020). The government offers tax incentives to encourage citizens to use these retirement plans to save more for retirement (Cahill, 2020).

4.3.3.2 The Registered Pension Plan

An RPP is an employer or union funded retirement fund that allow both the employee and employer to contribute towards the retirement of the employee (Cahill, 2020). There are two types of RPPs, namely the defined contribution pension plan and a defined benefit pension plan (Canada Life, 2024). A defined contribution pension plan is where the source of retirement depends on the investment returns whilst a defined benefit pension plan does not depend on the

performance of the investment and the employee will receive fixed monthly payments at retirement (Canada Life, 2024). Both the employer and employee can decide how much they want to contribute to the fund, but the contribution should be a minimum of 1% of the pensionable earnings but must not exceed the maximum pensionable earnings ceiling of \$68 500 per annum for 2024 which is adjusted annually for inflation (Dollar, 2023b). The contribution is made from a pre-tax income before the employer deducts taxes from the employee's gross salary (Gustafson, 2019).

In the majority of Canadian provinces and territories, RPP can be withdrawn when the individual reaches the age of 55 years whilst in other territories pension funds allow a one-time withdrawal for up to 50% of the value of the benefits (Dollar, 2023a). However, depending on the provinces or territories, an individual may be allowed to withdraw from the RPP before the age of 55 years in case of an emergency (Dollar, 2023a). The emergency includes when an individual has low income, the home is up for repossession, when the individual is being evicted due to inability to pay house rent, high health care bills and reduced life expectancy (Dollar, 2023a).

At retirement, employees can decide to receive the benefits in the form of a monthly annuity or as a lump sum. Should the employee resign, they get to keep their employee contribution plus any investment growth, however, the employer's contribution and the investment growth thereof is subject to vesting periods of the specific employee (Dollar, 2023b). Should the vesting periods be met, the individual also gets to keep the employer's contribution and growth thereof (Dollar, 2023b). Should the pension regulations allow, the funds can only be transferred to another pension plan or locked in a retirement account until you reach retirement age (Canada Life, 2023). However, should the RPP not be locked in, the individual is entitled to take out the full cash value as a lump sum (Canada Life, 2023).

4.3.3.3The Registered Retirement Savings Plan

A RRSP is a retirement savings plan that the individual opens to save for their retirement that is not linked to employment (TurboTax, 2022). The employer can however choose to contribute towards the RRSP, and such employer contributions will be treated as taxable income in the hands of the employee (Sylvestre-Williams, 2023). Individuals can contribute 18% of the previous year's earnings limited to the maximum limit of the tax year which is \$31 560 for the 2024 tax year (TurboTax, 2022). Income earned by the fund on the contributions is exempt from tax provided that the funds remain in the account (TurboTax, 2022).

Individuals can withdraw the funds in the RRSP at any given time provided that the funds are not in a locked in plan and subject to the rules of the RRSP fund (TD Bank, 2023). Funds in a locked in plan cannot be withdrawn until a specific condition is met which is normally reaching retirement

age of 71. Therefore, individuals with RRSPs can withdraw the funds at any time should they need funds including for emergencies, retirement or when they resign. However, RRSPs automatically mature at the end of the year the individual turns age 71 and the individual must withdraw the RRSP (TD Bank, 2023). At maturity, the individual can either withdraw all funds in cash, convert the RRSP to a registered retirement income fund (RRIF) or purchase a life annuity that provides guaranteed income payments for the rest of the individual's life (TD Bank, 2023).

Individuals can also withdraw from an RRSP without incurring any withholding tax or income taxes provided that the withdrawn amount is used to purchase a home for the first time or used to pay for the individual's or their spouse's education (TD Bank, 2023). However, the money withdrawn must be paid back into the RRSP within the stipulated time frames or failure to do so will result in the withdrawn funds being treated as taxable income in the hands of the individual.

4.3.3.4 The Registered Retirement Income Fund

An RRIF is an investment fund that pays out RRSP transferred funds in income during retirement. Individuals must withdraw a minimum amount annually from the RRIF which is based on a percentage that is dependent on the age of the individual and there are no maximum withdrawal limits (Sun Life, 2024a). The investment in the RRIF will not be subjected to tax but only the withdrawal is subject to tax (Sun Life, 2024a).

Individuals who opt to receive the RRIF will qualify for a \$2 000 tax credit provided that they are 65 years or older during the year which is applied against the amount of money owed in taxes (Sun Life, 2024a). For federal tax purposes, this credit is offered at the lowest federal tax rate, which is 15%, or \$300. If the individual does not need to use the entire credit to reduce their federal taxes to zero, they can transfer any remaining unused amount to the spouse or common-law partner (Sun Life, 2024a). Any unused portion cannot be carried forward to future tax years (Sun Life, 2024a).

The key differences between the RPP, RRSP and the RRIF as discussed above, lies in the structure and the purpose. RPPs are linked to the employment of an individual and are employer sponsored whilst RRSP's are more similar to the South African version of the retirement annuity funds that are not linked to employment and are opened by the employee at their own accord. On the other hand, RRIFs are similar to the South African version of preservation funds that allow minimum mandatory annual withdrawals. The tax implications of RPPs and RRSPs at withdrawal are discussed next.

4.3.3.5 Tax implications of an RPP

RPP contributions both made by the employer and employee are not subject to tax for Canadian residents (Hammer, 2024). Employees are entitled to deduct the full employee contributions from their income when calculating their taxable income (Canada Life, 2024). Employer's contributions to the RPP are exempt from payroll taxes in the hands of the employee. The investment earnings of the fund are not subject to tax, provided they remain within the fund (Canada Life, 2024). Therefore, the earnings of the fund are taxable when the funds are withdrawn.

When employees retire and start receiving the benefits, the receipts either in the form of an annuity or lump sum will be included in the employee's income when calculating the taxable income (TurboTax, 2022). Therefore, RPP withdrawals will be taxed as regular income, and the tax will be determined using the individual's regular marginal tax tables as follows:

Table 4-3: Federal Income tax rates (Canada)

If Taxable Income Is:	The Tax Is:
Not over \$55 867	15% of the taxable income
Over \$55 867 but not over \$111 733	20,5% of taxable income
Over \$111 733 but not over \$173 205	26% of taxable income
Over \$173 205 but not over \$246 752	26% of taxable income
Over \$246 752	33% of taxable income

Source: Government of Canada (2024)

The tax treatment of RPP withdrawals is aligned with the general principles of Canada's progressive tax system that seeks to tax the rich more and the poor less which ensures a fair and equitable distribution of the tax burden.

4.3.3.6 Tax implications of an RRSP

Employees are entitled to deduct the full employee contributions from their income when calculating their taxable income. Any unused RRSP contributions can be carried forward as a deduction in future years (TD Bank, 2023).

At withdrawal of the RRSP, the individual must include the amount withdrawn as income when completing their income tax returns (Sun Life, 2024b). The amount will be taxed according to the federal tax tables as depicted Table 4-3 above, depending on the taxable income of the individual. The RRSP fund will withhold a certain percentage as shown below of the RRSP withdrawal benefit and pay it over to the Canada Revenue Authority and the withheld amount will be used as a prepayment against the total tax liability for the year (Sun Life, 2024b). When the individual submits their income tax return for the year, the tax withheld amount is used as a tax credit to offset any income tax due on their taxable income, which includes the RRSP withdrawal. If the

amount withheld exceeds the actual tax liability, a tax refund will be provided to the individual. Conversely, if insufficient tax was withheld, additional tax may still be payable to the Canada Revenue Authority.

When an individual withdraws before maturity of the RRSP, withholding tax will be calculated on the full amount withdrawn and the withdrawn amount will be included in the income when completing the tax returns (Sun Life, 2024b).

However, if the individual withdraws all the fund benefits in cash as a lump sum at maturity, the entire amount will be subject to withholding tax (Sun Life, 2024b). Should the RRSP be converted into an RRIF, no withholding tax is payable on withdrawal of the minimum amount (Sun Life, 2024b). However, withholding tax only applies on the amounts withdrawn from the RRIF that are above the minimum amount. No withholding tax is payable on a life annuity and the full amount of the annuity payment will be included in the taxpayer's income and will be taxed using the taxpayer's marginal tax rate (Sun Life, 2024b).

The RRSP withholding tax rates are as follows for Canadian residents (Sun Life, 2024b):

- 10% on amounts up to \$5,000
- 20% on amounts over \$5,000 up to and including \$15,000
- 30% on amounts over \$15,000

As Quebec operates its own provincial tax system that differs from the federal tax system, the RRSP withholding tax rates are as follows for Quebec residents (Sun Life, 2024b):

- 5% on amounts up to \$5,000
- 10% on amounts over \$5,000 up to and including \$15,000
- 15% on amounts over \$15,000

Messacar (2018) conducted a study to assess the effect of tax withholding on pre-retirement withdrawals from tax-preferred savings accounts in Canada. The findings suggest that tax withholding serves as a commitment device, particularly reducing withdrawals by financially unconstrained individuals, as it discourages myopic behaviour (Messacar, 2018).

As seen from the above, both RPP and RRSP withdrawals are taxed using the marginal tax rate with the difference being that RRSP withdrawals incur a withholding tax.

The tax implications at death of a member of an RRSP, RRIF or RPP will be discussed next.

4.3.3.7 Tax implications of employer sponsored plans at death

Where a member dies before withdrawing from an RRSP or RRIF, the full market value of the fund is deemed to accrue to the member at the date of death and will be included as income in the final tax return of the deceased (Royal Bank, 2024). However, the funds can be transferred to an RRSP or RRIF of the qualifying beneficiary and the consequence of this is that the qualifying beneficiary is taxed and not the deceased (TurboTax, 2023). The qualifying beneficiary will be taxed on the amount when they withdraw it from their RRSP or RRIF. A qualifying beneficiary includes a person who is 71 years or younger who is a spouse or common law partner of the deceased or children or grandchildren who were financially dependent on the deceased (TurboTax, 2023).

However, if the deceased leaves the funds to any other beneficiary that is not a qualifying beneficiary, the total value of the fund will be taxed in the deceased's final return and the remaining amount will be paid over to the beneficiaries. Therefore, the death benefit will be tax free in the hands of a non-qualifying beneficiary.

Similarly, for an RPP, when the plan member dies, a lump sum may be made available to the named beneficiaries or the estate of the deceased (Davis, 2018). An RPP lump sum paid over will be included in the recipient's taxable income and taxed in their hands (Davis, 2018). Therefore, the estate of the deceased or the beneficiaries will be taxed depending on who received the lump sum. When the estate pays over the RPP lump sum to the estate beneficiary, the income is taxable in the hands of the estate beneficiary and the estate can claim for a deduction against the estate income on the tax they paid on the lump sum (Davis, 2018).

However, if the beneficiary of an RPP is a spouse or a common law partner of the deceased, they can transfer the pension benefit to their own RPP, RRSP or RRIF and the transfer will be on a tax deferred basis (Davis, 2018). This means that the spouse or common law partner will only be taxed when they withdraw the money out of their own fund. The RPP plan administrator will withhold income tax before making payment to the recipient.

The Canadian retirement system as discussed above includes a mandatory government administered CPP and voluntary employer sponsored plans that are supplement to the retirement savings and provide tax incentives in the form of tax deductions of contributions and the deferral of tax on investment growth to encourage individuals to save more to supplement the CPP payout.

A comparison between the tax implications of South Africa and that of Canada will be discussed next.

4.3.4 Comparison of Canada with South Africa

In comparing the tax treatment of retirement funds in South Africa and Canada, it is found that both countries offer tax incentives to encourage retirement savings, but these are done in distinct ways. Canada has a government sponsored pension which is funded by mandatory contributions from both the employee and the employer throughout the individual's working life. However, South Africa does not have a similar government sponsored pension, instead it offers a state old-age grant which is means tested and not funded by employee contributions but rather by government taxes (SASSA, 2024).

In South Africa, there is no limit on how much can be contributed to retirement funds, providing greater flexibility for higher contributions, whilst in Canada contributions are subject to annual limits. In both South Africa and Canada, contributions to retirement funds are tax deductible which helps reduce the individual's taxable income. However, in South Africa, contributions are deductible up to a certain limit as prescribed by section 11F of the ITA that is currently R350 000.

Both countries allow for the growth within the retirement fund to be tax deferred until the funds are accessed. In South Africa, withdrawals at retirement are partially tax-free to a specified threshold and any amount exceeding the limit is taxed using the favourable retirement tax table. Resignations from the fund are, however, taxed using an unfavourable table which has a smaller tax-free amount compared to the retirement tax table.

Both countries allow individuals to access their savings early, however South Africa, according to new legislation, now allows individuals to access a portion of the retirement once a year. On the other hand, members of the Canadian RPP can access their savings early only in emergencies such as low-income, home repossession and others whilst South African's can withdraw from the two-pot retirement system without having to provide any reason, limited to one withdrawal a year and a minimum of R2 000. In addition, members of the Canadian RRSP can access their retirement at any given time even for emergencies, provided that the funds are not in a locked-up plan.

Withdrawals from the two-pot retirement system in South Africa are included in the individual's taxable income and taxed using the normal tax tables. In Canada, any withdrawal will be included in the individual's taxable income and the tax will be calculated using the federal tax tables.

In Canada, there are no separate tax tables specifically for retirement income and as such the withdrawals are fully taxable as ordinary income with no tax-free portion like in South Africa.

In conclusion, South Africa and Canada's retirement systems are comparable as both countries aim to encourage retirement savings through tax incentives particularly the tax deductibility of

contributions. However, there are key differences in terms of the tax treatment. South Africa offers partial tax exemption but imposes stricter and higher tax rates on individuals who resign and access their savings before retirement. Canada taxes all withdrawals from retirement funds as ordinary income regardless of whether it was due to a retirement, resignation or early access using the normal federal tax rates.

The background and the income tax implications of retirement funds in the UK will be discussed next.

4.4 United Kingdom

4.4.1 Introduction

The UK retirement system is ranked among the best in the world, currently sitting in 15th place according to the Melbourne Mercer Global Pension Index (Richardson, 2024). The system has undergone numerous major reforms, including the introduction of automatic enrolment for workplace schemes and an increase in the retirement age (Richardson, 2024). These reforms aim to ensure sufficient retirement savings and improve the quality of life for retirees.

The UK retirement system comprises two main components, the UK pension system and private pensions that includes workplace pensions, and personal pensions (Richardson, 2024). The UK pension scheme is government-backed, workplace pensions are employer-sponsored, and personal pensions are funded by individuals meaning that the individual finds the provider and makes the contribution (Jark, 2023).

The background and tax implications of the UK pension system will be discussed next.

4.4.2 The UK pension system (National Insurance)

The UK pension scheme is state pension sponsored by the UK government that requires everyone who is above the age of 16 years and is an employee who earns more than £242 per week from one job or is self-employed and makes a profit of more than £12 570 per annum to contribute to the National insurance (UK Government, 2024a). The National Insurance depends on the employment status and the earnings of the employees. The National Insurance rates change every year and the rates for the period 6 April 2024 to 5 April 2025 are as follows:

Table 4-4: UK National Insurance contributions (UK)

Pay	Rate
£242 to £967 per week	8%

Over £967 per week	2%
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Source: UK Government (2024a)

The employer contributes towards the employees' National Insurance at a rate that depends on the employee's category letter (UK Government, 2024a). The employer deducts the National Insurance contribution from the employee's pay and pay it over to His Majesty's Revenue & Customs along with the employee's tax. National Insurance is a separate tax on its own and only individuals who contributed towards the National Insurance qualify for the UK state pension. Employees can only access the state pension when they reach the state pension age (Moneyhelper, 2024). The pension age depends on the year of birth of the employee and has been changing gradually over the past few years (Moneyhelper, 2024). The state pension age is currently 66 years and is set to increase to 67 years from 6 May 2026 (AgeUK, 2024).

When employees reach the state pension age, they can choose to defer their state pension and continue working without the need to continue contributing to the National Insurance (UK Government, 2024e). Deferring the state pension could result in receiving larger payments when they eventually claim, which will be higher than what they would have received should they claimed when they reach the state pension age (Richardson, 2024). To receive the State Pension, employees must submit a claim to the Pension Service, as it is not granted automatically. If an employee does not submit a claim, the pension will be automatically deferred until a claim is made (Richardson, 2024).

For the 2024/2025 tax year, the State Pension is currently £221,20 per week which equates to an annual amount of £11 502,40 (Moneyhelper, 2024). Individuals may receive a lower amount depending on their contributions to the National Insurance (Moneyhelper, 2024). Employees need a minimum of ten years' contributions to qualify for any state pension and at least 35 years of contributions to get the full amount (Moneyhelper, 2024).

The state pension is paid every month in arrears and the gross amount is paid to the individual without any tax deducted. While the state pension is taxable, no tax is deducted when it's paid to the individual as they receive a standard tax-free personal allowance of £12 570 for the 2024/2025 tax year (AgeUK, 2024). However, if the individual's income is above £100 000, the personal allowance of £12 570 is reduced at a rate of £1 for every £2 of income above the threshold (AgeUK, 2024).

If an individual receives the full state pension of £11 502,40, the entire amount will be tax free. However, if the individual's total taxable income is more than the personal allowance, tax can be collected by means of Pay-as-you-earn or at the annual self-assessment return (AgeUK, 2024).

The unused portion of the standard tax-free personal allowance can be used as a deduction against other taxable income.

In conclusion from the above, the UK National Insurance payout is effectively tax-free due to the personal allowance that acts as a form of a deduction. An important highlight is that individuals must contribute for at least 35 years to enjoy the full benefit of the state pension, emphasizing the point that individuals have a huge role to play to ensure their financial security at retirement by consistently contributing towards the National Insurance.

The tax implications of the private pension's component of the UK retirement system will be discussed in the next section of the study.

4.4.3 Private Pensions

Private pensions include both workplace and personal pensions and they provide ways for individuals and employers to save for retirement to supplement the state pension amount (Hepplestone, 2024). Private pensions are commonly defined contributions plans that depend on the payments made and the investment return earned on the savings (Hepplestone, 2024). As of 2019, workplace pensions are now mandatory for all employers, and employees will be automatically enrolled if they meet the qualifying criteria (Richardson, 2024).

To be automatically enrolled, the employee must be classed as a worker, be aged between 22 and State Pension age (66 years of age), earn at least £10,000 per year, ordinarily work in the UK (UK Government, 2024b). Both the employer and the employee must contribute towards the pension and a minimum of 8% of the total earnings must be contributed to the workplace pension which is broken down into 3% for the employer and 5% for the employee (Hepplestone, 2024). However, the contribution amounts could be higher depending on the pension scheme rules or should both the employer and employee opt to contribute more.

The government also contributes to workplace pensions and personal pensions in the form of a tax relief as the money that would have gone to the government as income tax goes directly into the pension fund (nidirect, 2024). Employees receive a full tax relief on any contributions by the employer towards the employees' pension and no tax is deducted from the employer contributions as the contributions are generally made from the pre-tax income (Fidelity, 2024a). Therefore, the employer contributions are not taxable benefits in the hands of the employee as no tax is paid but the employer qualifies for a tax relief as a business expense.

The tax relief is available on the employee's pension contribution at the highest rate of the income tax applicable to the employee (Green, 2024). Non-taxpayers, who are those earning under the personal allowance, generally do not receive pension tax relief unless they are in a relief at source

scheme (nidirect, 2024). Basic-rate taxpayers receive 20% pension tax relief, higher-rate taxpayers receive 40% pension tax relief, and additional-rate taxpayers receive 45% pension tax relief (Green, 2024). Taxpayers are classified as basic, high, or additional rate taxpayers depending on their earnings band which is depicted in Table 4-5

The tax relief works in two key ways, which are relief at source and net pay (nidirect, 2024). Relief at source is when the pension contribution is made to the pension provider from the employee's pay after deducting the tax and the National Insurance contribution (nidirect, 2024). This normally occurs for personal pension contributions that the employee makes themselves from the net pay they received from the employer. The pension provider claims the basic rate tax relief of 20% from His Majesty's Revenue & Customs and adds it to the pension pot (Green, 2024).

Under the net pay mechanism, the pension contribution is taken out before deducting tax, therefore the tax relief is received immediately at the individual's highest marginal rate, and it is not necessary to claim it back (nidirect, 2024). This normally occurs with workplace pensions where the employer deducts the contributions from the salary before tax. However, the disadvantage of net pay is that no tax relief is available if the individual does not pay tax (Green, 2024).

Individuals can access their retirement savings when they reach the age set by the pension scheme, which generally ranges between 55 years and 65 years, depending on the pension scheme rules (UK Government, 2024b). However, early access to the pension can be allowed in certain circumstances before the age of 55 years (UK Government, 2024b).

Individuals may access their pension pot before age 55 if they are retiring due to ill health or due to a protected retirement age (PensionBee, 2024a). A protected retirement age allows access to the pension before the standard pension age under specific circumstances often linked to occupations such as police officers or military services and such protection must have been granted before 6 April 2006 (PensionBee, 2024a).

Therefore, withdrawing from the pension before the age of 55 years, unless its due to ill health or protected retirement age, is not allowed. Withdrawing before the age of 55 years without meeting the two conditions above is unauthorised and will be regarded as an unauthorised payment which will attract up to 55% tax (UK Government, 2024d).

When individuals resign from their employment, the workplace pension will remain invested until the individual reaches pension age or can be transferred to the new employer's workplace pension (UK Government, 2024b).

In the UK, workplace and personal pensions follow on the EET model (Mirza-Davies, 2024). This means contributions for both employer and employee are exempt through the tax relief, the growth in the pension savings is exempt from tax but the withdrawal of the pension benefits is subject to tax. However, the annual allowance places a limit to tax free contributions. This means that any contributions to pension schemes that exceed £60 000 each year will be subject to the annual allowance charge (Mirza-Davies, 2024). The individual is liable for the annual allowance charge on any contributions made by the employer or own contributions that exceed the limit (M&G Wealth, 2024). The excess contribution will be added to the individual's taxable income for the year and taxed at the marginal income tax rate (The Pearson Pension Plan, 2024).

Individuals are allowed to take 25% of the pension savings tax-free which can be taken as a tax-free lump sum or a series of tax-free withdrawals (PensionBee, 2024b). However, the total tax-free portion is capped to £268 275 if you have £1 073 100 or more saved (PensionBee, 2024b). The remaining 75% of the pension savings is moved to a drawdown pot that can be accessed immediately or at a point in the future as income. The rest of the benefits will be taxed as earned income when withdrawn by the individual under the income tax rules (PensionBee, 2024b). The benefits will be taxed using the below tax table, Table 4-5, which is the same for all income earned including retirement benefits.

Table 4-5: Income tax rates (UK)

	Rate	Earnings
Personal allowance	0%	£12 570
Basic rate tax	20%	£12 571 to £50 270
Higher rate tax	40%	£50 271 to £125 140
Additional rate of tax	45%	Over £125 140

Source: UK Government (2024c)

From the above it is found that the UK private pension system, which includes workplace and personal pensions, provides an opportunity to individuals to supplement the state pension and encourages retirement savings by using tax relief methods such as exempting growth and providing a certain portion of the savings tax-free.

The implications of the private pensions at death will be discussed next.

4.4.4 Implications at death

When an individual dies, the unwithdrawn pensions savings can be passed to beneficiaries nominated by the individual before death. When an individual dies before the age of 75, the beneficiaries normally do not pay any income tax on the benefits they receive (Pennells, 2024). However, if a lump sum is paid out and exceeds the deceased's remaining lump sum allowance, the excess will be subject to income tax in the hands of the beneficiary (Pennells, 2024). If an individual dies aged 75 or over, the benefits paid over to the beneficiaries will be subject to income tax in the beneficiaries' hands at the rate that applies to them (Pennells, 2024).

It is evident that the UK tax system is more beneficial to the beneficiary where the deceased passes before reaching the age of 75 years as they can receive the benefits tax-free.

A comparison of the tax implications between South Africa and UK will be discussed next.

4.4.5 Comparison of the UK with South Africa

From the above discussions it is found that similarly, to Canada, the UK has the National Insurance that is a government sponsored pension plan wherein both the employer and employee contribute towards the individual's working life. However, South Africa does not have a similar government sponsored pension, instead it offers a state old-age grant which is means tested and not funded by employee contributions, but rather by government taxes. The UK state pension can be tax free provided that the individual's total taxable income is below the personal allowance. Individuals do not receive any deduction for contributions towards the National Insurance.

Both South Africa and the United Kingdom offer tax benefits on contributions to retirement funds, where contributions by employees and employers are typically tax-deductible, reducing the taxable income during the contribution phase. However, in the UK, any excess contributions will be included in the individual's taxable income and taxed at their marginal rates. When it comes to the treatment of investment growth within the funds, both countries defer the tax on growth earnings until they are withdrawn from the fund. In South Africa, employer contributions are taxable in the hands of the employee as a taxable benefit but deductible in terms of section 11F of the ITA which is therefore not effectively taxed, whilst in the UK it is not a taxable benefit in the hands of the employee as no tax is paid on it.

The treatment of retirement income shows some divergence. In both South Africa and the UK, retirement income received as an annuity or pension is subject to income tax at the individual's marginal rate. Additionally, both countries allow individuals to access a portion of their retirement tax-free, with South Africa permitting the first R550 000 of a retirement benefit and first R27 500 of withdrawal benefit tax free and the UK offering a 25% tax-free portion of the pension pot.

However, South Africa uses a separate tax table to determine the tax for lump sums from retirement or resignation, while the UK applies its standard income tax tables to any additional withdrawals beyond the tax-free portion.

In the UK, unauthorized withdrawals before the age of 55 years are heavily taxed, while in South Africa, withdrawal from the vested pot of retirement fund before reaching retirement age are taxed according to a progressive tax table with a smaller tax-free portion compared to retirement withdrawals before 1 September 2024. From 1 September 2024 no withdrawals can be made out of the retirement pot without reaching retirement age and withdrawals from the savings pot will be tax at the marginal tax rate of the individual, but a minimum amount of R 2 000 and no reasons has to be provided. The UK allows individuals to withdraw early in limited circumstances and such withdrawal will be taxed using the tax rate of the individual.

Upon death, the tax treatment also differs. In the UK, if the individual dies before 75 years, the beneficiaries receive the death benefit tax-free, whereas in South Africa, the deceased person is taxed as the lump sum benefit is deemed to accrue immediately before death, provided the deceased died before retirement age. However, if the deceased was already receiving retirement benefits in the form of a living annuity and the beneficiary opts to take it out as a lump sum, the beneficiary will not be subject to tax if he commutes the living annuity to a lump sum. Therefore, the deceased will be taxed on any benefits accrued up to date of death.

In conclusion, the tax treatment of retirement funds in South Africa and the UK shows both similarities and notable differences. Both systems provide tax benefits during the contribution and accumulation phases, encouraging retirement savings. However, differences arise in the treatment of employer contributions, excess contributions, and premature withdrawals. However, the UK's system is more favourable in the treatment of employer contributions as they are not taxed in the hands of the employee. In South Africa, whilst employer contributions are included in the gross income, they are deductible subject to certain limits making a certain portion tax-free.

The next section of the study will discuss the tax implications of retirement funds in the USA.

4.5 United States of America

4.5.1 Introduction

The USA Retirement system is made up of three streams that all provide retirement benefits to individuals when they retire, namely the government sponsored pensions, employer sponsored pensions and employee sponsored pensions (Friedberg, 2024). Government sponsored pensions includes the social security that is sponsored by the Federal government whereas the employer

sponsored includes defined benefit plans and defined contributions plans. Individuals can also save towards their retirement by opening individual retirement accounts.

The government sponsored social security is discussed in the next section of this chapter, whereafter the consideration of employer sponsored plans follows, and lastly individual retirement accounts are discussed.

4.5.2 Social Security

4.5.2.1 Background of the Social Security

Social Security is a federal program in the USA that provides financial protection in the form of retirement benefits to eligible retired individuals, as well as disability benefits to those who are unable to work due to a qualifying disability, and survivor benefits to the dependents of deceased workers (Social Security Administration, 2024c). This program was designed to help mitigate the financial risks associated with loss of income due to retirement, disability, or death.

The Social Security is funded by the Social Security Tax which is withheld by the employer from the employee's annual wages at a rate of 6,2% on the first \$168 600 (Boyte-White, 2024b). Employees' income above \$168 600 is not subject to social security tax. The limit caps are revised every year. Both the employer and the employee contribute 6,2% of the employee's wages bringing the total social security contribution to 12,4% (PWC, 2024). Self-employed individuals pay a social security tax of 12,4% as they are considered both the employer and employee (PWC, 2024).

At retirement, employees need to have the minimum number of Social Security credits to be eligible for the retirement benefits (Social Security Administration, 2024b). These credits are earned by employees based on their total wages, self-employment income and work history. As of 2024, employees earn one Social Security credit for every \$1,730 in covered earnings within a year, and they can earn up to a maximum of four credits per year (Social Security Administration, 2024b). Therefore, individuals who earn at least \$6,920 in 2024 will receive the maximum of four credits for that year. To qualify for social security retirement benefits, workers must earn at least 40 social security credits which equates to at least ten years of work (Social Security Administration, 2024b).

The earliest possible retirement age for Social Security is at age 62 which is regarded as an early retirement (Social Security Administration, 2024f). The retirement age is currently 67 years for individuals born in 1960 or later, decreases to 66 for individuals born between 1943 and 1954 and increases gradually for individuals who were born in 1995 to 1960 until it reaches the age of 67 (Social Security Administration, 2024f).

Individuals who take early retirement at age 62 will receive reduced benefits by approximately 30% compared to the full benefits that they would have received if they waited until age 67 (Social Security Administration, 2024a). As the Social Security replaces a percentage of the worker's pre-retirement income, the amount of the benefit depends on how much the employee earned whilst they were still working and when they choose to start receiving the benefits (Social Security Administration, 2024f). If individuals start benefits at age 67, the Social Security replacement rate ranges from as much as 78% of pre-retirement earnings for very low earners, to about 42% for medium earners, and around 28% for high earners (Social Security Administration, 2024f). However, if the benefits are received earlier than age 67, these replacement rates would be lower (Social Security Administration, 2024f). After age 67, the replacement rates would be higher.

The retirement benefits amount is calculated using the average indexed monthly earnings which summarises up to 35 years' highest earnings (Social Security Administration, 2024a). The average indexed monthly earnings are calculated by adjusting the workers past earnings to account for wage inflation during their employment years (Social Security Administration, 2024a). The highest 35 years of indexed earnings are added together and divided by the number of months in those years then rounded down to the nearest dollar (Social Security Administration, 2024a). A formula is applied to the average indexed earnings to determine the primary insurance amount which is the basis that benefits are paid to individuals. The formula reflects the changes in the general wage levels as indicated by the national average wage index (Social Security Administration, 2024a).

4.5.2.2 Deductibility of the contributions

The Social Security contributions made by both the employer and the employee are not tax deductible when determining the employees' taxable income (PWC, 2024). However, for self-employed individuals, a deduction is allowed for the employer contribution equivalent portion of the Social Security contribution to be made when calculating the gross income (IRS, 2024a). This relates to the contribution that the individual pays that the employer would have paid if the person was employed (IRS, 2024a).

4.5.2.3 Tax on the retirement benefits

The tax paid on retirement benefits depends on the individual's filing status and the taxable income level. If the federal return is filed as an individual and the individual's annual combined income is between \$25 000 and \$34 000, 50% of the Social Security benefits will be subject to tax (Social Security Administration, 2024f). Therefore, the remaining 50% will be tax free. However, if the combined income is more than \$34 000, up to 85% of the social security benefit will be subject to tax (Social Security Administration, 2024f). If the federal return is filed as a joint

return and the combined income of both the individual and their spouse is between \$32 000 and \$44 000, 50% of the social security benefit will be subject to tax (Social Security Administration, 2024f). However, if the combined joint income is above \$44 000, up to 85% of the Social Security will be subject to tax (Social Security Administration, 2024f). An individual who is married and files a separate federal return will pay taxes on the entire social security retirement benefit (Social Security Administration, 2024f).

The taxable portion of the Social Security benefit will be included in the individual's taxable income and taxed according to the regular Internal Revenue Service (IRS) tax tables that applies to all ordinary income. The following tax tables, applicable for the 2024 tax year, are used.

Table 4-6: Tax table for a taxpayer who files as an individual (USA)

If Taxable Income Is:	The Tax Is:
Not over \$11,600	10% of the taxable income
Over \$11,600 but not over \$47,150	1,160 plus 12% of the excess over \$11,600
Over \$47,150 but not over \$100,525	5,426 plus 22% of the excess over \$47,150
Over \$100,525 but not over \$191,950	17,168.50 plus 24% of the excess over \$100,525
Over \$191,950 but not over \$243,725	39,110.50 plus 32% of the excess over \$191,950
Over \$243,725 but not over \$609,350	55,678.50 plus 35% of the excess over \$243,725
Over \$609,350	183,647.25 plus 37% of the excess over \$609,350

Source: IRS (2023)

Table 4-7: Tax table for a taxpayer who files a joint return (USA)

If Taxable Income Is:	The Tax Is:
Not over \$23,200	10% of the taxable income
Over \$23,200 but not over \$94,300	2,320 plus 12% of the excess over \$23,200
Over \$94,300 but not over \$201,050	10,852 plus 22% of the excess over \$94,300
Over \$201,050 but not over \$383,900	34,337 plus 24% of the excess over \$201,050
Over \$383,900 but not over \$487,450	78,221 plus 32% of the excess over \$383,900
Over \$487,450 but not over \$731,200	111,357 plus 35% of the excess over \$487,450
Over \$731,200	196,669.50 plus 37% of the excess over \$731,200

Source: IRS (2023)

Table 4-8: Tax table for a taxpayer who is married but files separately (USA)

If Taxable Income Is:	The Tax Is:
Not over \$11,600	10% of the taxable income
Over \$11,600 but not over \$47,150	1,160 plus 12% of the excess over \$11,600
Over \$47,150 but not over \$100,525	5,426 plus 22% of the excess over \$47,150
Over \$100,525 but not over \$191,950	17,168.50 plus 24% of the excess over \$100,525
Over \$191,950 but not over \$243,725	39,110.50 plus 32% of the excess over \$191,950
Over \$243,725 but not over \$365,600	55,678.50 plus 35% of the excess over \$243,725
Over \$365,600	98,334.75 plus 37% of the excess over \$365,600

Source: IRS (2023)

The tax tables presented above provide a clear breakdown of how the taxable income, which includes the social security, is taxed depending on the filing status of the individual. Furthermore, the table highlights the progressive nature of the US's tax system that seeks to tax the rich more.

4.5.2.4 Implications of Social Security at death

When the member passes on, the Social Security benefits of the deceased are provided to the surviving spouse, children, or parents of the deceased. The number of credits required for the survivor benefits to be payable to the dependants depends on the age at which the deceased contributor passed on (Social Security Administration, 2024b). The younger the deceased is, the less credits are needed (Social Security Administration, 2024b). This ensures that families with particularly young children have financial protection even if the deceased had not worked long enough to earn the minimum 40 credits required for retirement benefits (Social Security Administration, 2024b).

The survivor benefit amount depends on the work history and the earnings of the family member who died (Social Security Administration, 2024d). A surviving spouse is eligible to receive the benefits if they are 60 years or older, or 50 years or older and have a qualifying disability (Social Security Administration, 2024e). The surviving spouse of any age can receive the benefits if they are caring for the deceased's child who is under 16 years old or who has a qualifying disability (Social Security Administration, 2024e).

The deceased's children are eligible to receive the benefits if they are unmarried and younger than 18 years old, or between 18 and 19 years and full-time students in elementary or secondary school (Social Security Administration, 2024e). They are also eligible if they are aged 18 and older and has a qualifying disability that began before the age of 22 years (Social Security Administration, 2024e).

The parents of the deceased are eligible for the benefits if they were dependant on the deceased for at least half of their support (Social Security Administration, 2024e). A one-time payment of \$255 may be paid after the deceased's death to the surviving spouse or minor children (Social Security Administration, 2024e). The survivors benefit amount is a percentage of the deceased's basic security benefit which ranges from 75% to 100% (Social Security Administration, 2024e). There is a limit on the amount that can be paid each month which is generally 150% to 180% of the deceased's benefit rate (Social Security Administration, 2024e).

Survivor benefits can be taxable depending on the recipient's income and the filing status (Smartasset, 2024). If half of the survivor benefit plus other income exceeds \$25 000 per annum,

a portion of the benefits are taxable (Smartasset, 2024). However, if half of the benefits plus total income is below \$25 000, no tax will be payable on the survivor's benefits. For married couples that file jointly, the income threshold is \$32 000 and if the combined income exceeds the limit, a portion may be taxable (Smartasset, 2024).

For an individual with a combined income between \$25,000 and \$34,000, or a married couple filing jointly with a combined income between \$32,000 and \$44,000, up to 50% of your survivor benefits may be subject to income tax (Smartasset, 2024). If the combined income exceeds the limits, up to 85% of your survivors' benefits will be taxable.

Survivor benefits paid to children are taxable in the hands of the child, however, most children do not meet the income levels to be taxed (Segal, 2023). If the survivor benefits are the only income for the child, they are not taxable (Segal, 2023).

In conclusion as found in the above discussion, the Social Security plays an important role in providing financial security to retirees. However, it benefits the lower income earners more as they get a higher replacement rate compared to medium to high income earners, therefore creating a regressive system where high income to medium income earners contributing more but receiving less. The high retirement age of 67 years forces individuals to work until later in life which can be challenging for individuals with physically demanding jobs or health issues, ultimately forcing them to retire early and settle for a reduced Social Security benefit.

The next part of the section will discuss the tax implications of employer sponsored plans.

4.5.3 Employer sponsored Plan's

4.5.3.1 Background

Employer sponsored plans are plans where the employer contributes towards the employee's retirement savings. The employee also contributes to the pension through deductions from their gross salary whilst the employer may match the employee's contribution. These plans include a defined benefit plan and a defined contribution plan. In a defined benefit plan, the employer guarantees a specific monthly amount to be paid to the employee after retirement irrespective of the performance of the investment pool and these are funded mainly by the employer (Gratton, 2024). Defined benefit plans are less common in private sectors due to the costs and risk associated with them (Gratton, 2024).

In a defined contribution plan, the benefits paid out to the employee depends on the performance of the investment plan and benefits end when the total contributions have been depleted (Gratton, 2024). One of the key distinguishing factors between a defined benefit and a defined contribution

is that the defined benefit plan pays the benefit until the member dies whilst a defined contribution pays until the funds are depleted.

The 401(k) plan is one of the most common defined contribution pension plans in the USA as it is less expensive for companies, and it is easier to estimate long term costs (Gratton, 2024). The 401(k) plan will be discussed next.

4.5.3.2 The 401(k) plan

4.5.3.2.1 Overview of the 401(k) plan

A 401(k)-retirement plan is an employer sponsored plan that was named after a section of the United States Internal Revenue Code where the employee contributes a certain percentage of their gross pay to the fund through a payroll deduction (Fernando, 2024). The employer may match the employee contributions, and in some plans, it is mandatory for the employer to match the employee's contribution (Fernando, 2024). There are two 401(k) plans, namely the traditional and the Roth plan (Fernando, 2024). In a traditional 401(k) plan, the employee contributions to the pension plan are made from the pre-tax amount with withdrawals subject to tax at retirement (Fernando, 2024). On the other hand, in a Roth 401(k) plan, employee contributions are made from the post tax amount and the withdrawals at retirement may be tax free if certain requirements are met (Fernando, 2024).

Employee contributions for 2024 are limited \$30 500 for employees aged 50 years above, while employees under 50 are capped at \$23 000 per annum.

4.5.3.2.2 Deductibility of contributions

The deductibility of the contributions varies depending on whether the 401(k) is a traditional plan or a Roth plan. As the contributions to the traditional 401(k) are taken out of the employee's gross salary before any taxes, they are paid over to the retirement fund before being taxed (Schwab, 2024). The 401(k) contributions will effectively lower the employee's taxable income as the taxes are calculated on the employee's salary less the 401(k) contribution's thereby effectively using a lower base to calculate the income tax (Schwab, 2024). Therefore, the contribution is not an actual tax deduction on the return as the contributions were made from the pre-tax salary.

In a Roth 401(k) plan, the contributions are paid over to the retirement fund from the after-tax income of the employee (Parker, 2024). The employee does not get a tax deduction as the tax has already been paid on the contributions. The tax benefit for the employee is deferred until retirement as the Roth earnings are tax free.

In conclusion, while the traditional 401(k) plan provides individuals with an immediate tax relief, it can result in a huge tax burden at retirement. On the other hand, the Roth 401(k) does not provide an immediate tax relief and is beneficial for individuals who seek to enjoy a tax-free retirement and on face value seems to be the best option for individuals to take.

4.5.3.2.3 When can individuals access their 401(k)

Individuals can access their 401(k) at the age of 59.5 years without incurring any penalty (Adams, 2024a). Those who withdraw their 401(k) retirement savings before reaching age 59.5 will incur a 10% early withdrawal penalty in addition to the normal income tax levied on the withdrawal (Adams, 2024a). However, if the individual meets the requirements of the rule of 55, withdrawals can be made from the 401(k) savings before age 59.5 years without an early withdrawal penalty (Adams, 2024a).

The rule of 55 is an IRS provision that allows individuals to withdraw from their 401(k) savings after reaching the age of 55 years without incurring an early withdrawal penalty (Waugh, 2023). For the rule of 55 to apply, the individual must resign from their job or lose their job in the year that they turn 55 years (Waugh, 2023).

Individuals who are facing financial hardship may withdraw from the 401(k) savings without incurring any early withdrawal penalties (Waugh, 2023). Situations classified as financial hardships include covering medical expenses, preventing foreclosure, paying for burial or funeral expenses, dealing with a permanent disability, or recovering from a qualified natural disaster (Waugh, 2023). However, certain type of government employees such as fire fighters may be able to access their retirement savings at age 50 without incurring any penalties for early withdrawal (Waugh, 2023).

In conclusion, the 401(k) plan provides flexibility as it allows individuals to withdraw their funds even before retirement at a penalty. However, this flexibility can be disastrous as individuals can deplete their retirement savings before their actual retirement and face financial insecurity during retirement. This will prompt them to rely on the Social Security which only replaces a portion of their earnings.

4.5.3.2.4 Options available at retirement

At retirement, individuals can choose to leave the retirement savings in the plan until they reach the age where the required minimum distributions kicks in (Boyte-White, 2024a). Individuals will be forced to take the required minimum distributions when they turn age 73 in the form of regular

and periodic distribution that are calculated based on the individual's life expectancy (Boyte-White, 2024a).

However, individuals may withdraw more than the required minimum distribution at any given year. Additionally, they can also choose to convert the retirement savings account into an individual retirement account (Boyte-White, 2024a). If the retirement savings are less than \$5 000, the employer is required to roll over the funds to an individual retirement account unless the individual opts to receive the amount as a lump sum (Boyte-White, 2024a). Alternatively, individuals can opt to start cashing out the retirement savings in the form of a lump sum, instalment payments or by purchasing an annuity from an insurer (Boyte-White, 2024a).

Ultimately, as seen above, the options available provide individuals with the flexibility to structure their withdrawals for their specific retirement needs and choose what they feel is best for them rather than receiving a payout and risk depleting the savings quickly. However, leaving the retirement savings until the required minimum distribution is the advantageous option as the funds continue to grow tax deferred.

4.5.3.2.5 Tax implications of withdrawals from 401(k) plans

The tax implications of withdrawals from the retirement savings whether at retirement, early access due to financial hardships or at resignation, depend on whether the plan is a traditional 401(k) plan or the Roth 401(k).

In a traditional 401(k) plan, the withdrawal will be treated as ordinary income and will be taxed at the tax bracket for the employee for the year as illustrated in Table 4-6, 4-7 and 4-8 depending on the filing status of the individual (Parker, 2024). However, in a Roth 401(k) plan, as the contribution was made out of the after-tax income of the employee and no deduction was received, the withdrawals will not be subject to tax provided that the retirement savings account was opened at least 5 years and the individual is 59.5 years or older (Parker, 2024).

If the employer matches the employee's Roth plan contributions, the employer's contribution to the Roth account will be treated as ordinary income in the hands of the employee in the year the employee withdraws and will be taxed using the employees tax bracket (Parker, 2024). A 10% early withdrawal penalty will be levied over and above the ordinary tax if the individual withdraws before the age of 59.5 years and do not meet the rule of 55 or the financial hardship conditions.

In conclusion, the option between the two plans provides individuals to trade-off between immediate tax relief or tax-free future withdrawals. However, the Roth plan is the most advantageous plan as it provides individuals with a tax-free withdrawal at retirement unlike the

traditional plan that can lead large tax burdens at retirement and potentially reduce the amount available at retirement.

Other plans available to individuals in addition to the 401(k) will be discussed next.

4.5.3.3 Other plans

In addition to the 401(k) plan, there is a 403(b) plan that is offered by tax exempt organisations employer's which works similar to a 401(k) plan, with the only difference that the 403(b) plan is only available to employees of public schools, state colleges and universities, church employees, ministers and clergy members and employees of tax-exempt organisations (Frankel, 2023).

Also similar to the 401(k) plan, there is the 457 plan that is only available to state and local government employees including certain highly compensated non-profit employees (Frankel, 2023).

The differences between the 401(k), 403(b) and 457 plans are illustrated in Table 4-9 below.

Table 4-9: Differences between the 401(k), 403(b) and 457 plans (USA)

	401(k)	403(b) (Fidelity, 2024b)	457 (Levy, 2024)
Eligibility	All private sector employees	Employees in education, faith-based organisations, and other tax-exempt organisations	State and local government employees and high paid non-profit employees
Who can contribute	Both the employer and employee contribute to the plan	Both the employer and employee contribute to the plan	Both the employer and employee contribute to the plan
Limitations to contributions	\$23 000 for employees below 50 and \$30 500 for employees above age 50	\$23 000 for employees below 50 and \$30 500 for employees above age 50	\$23 000 for employees below 50 and \$30 500 for employees above age 50
Type of plans available	Includes both the traditional and Roth plans	Includes both the traditional and Roth plans	Includes both the traditional and Roth plans

Accessible at age	59.5 years	59. 5 years	At any time without any penalties
Early withdrawal allowed	Allowed subject to a 10% penalty	Allowed subject to a 10% penalty	Allowed with no penalty

Source: Author's compilation of information presented above

In summary, while the 401(k), 403(b) and 457 plans have the same characteristics in terms of contribution limits, Roth and traditional plans, and employer contributions, the primary difference lie in eligibility. The 457 plan provides more flexibility to individuals as it is accessible at any time with no penalties, but this plan is not accessible to everyone, therefore the benefits are enjoyed by a selected few, being predominantly state employees. The implications of retirement at death of a member will be discussed next.

4.5.3.4 Tax implications of retirement funds at death

Where a retirement plan member dies before reaching retirement, the benefits that the deceased would have been entitled to are paid over to the beneficiary of the deceased in a form of a lump sum or an annuity (IRS, 2024b). If the retirement savings are inherited by the spouse of the deceased, the following options are available (Roberts, 2023):

- The spouse can take the retirement savings as a lump sum which will be treated as their ordinary income and taxed according to their tax bracket.
- The spouse can also roll over the deceased's retirement savings into their own retirement plan. If the spouse withdraws the money before reaching the age of 59.5 years, they will be subject to an early withdrawal penalty.
- The spouse can transfer the deceased's retirement savings into a new inherited Individual retirement account which will allow them to access the money before the age of 59.5 years without incurring an early withdrawal penalty.
- The spouse can also choose to leave the retirement savings in the deceased's retirement plan and take the required minimum distributions based on the life expectancy.

However, if the retirement savings are inherited by a non-spousal beneficiary, the options for the beneficiary are as follows (Roberts, 2023):

- The non spousal beneficiary can take the entire retirement savings of the deceased as a lump sum which will be treated as ordinary income in the hands of the beneficiary and

taxed according to their tax bracket. If the deceased's retirement savings was a traditional plan, the beneficiary will be taxed. However, if the deceased retirement plan was a Roth, the beneficiary will not be liable for any tax.

- The beneficiary can transfer the funds into an inherited Individual Retirement Account where the entire amount must be withdrawn within 10 years. The tax treatment will depend on whether the plan was a traditional plan or a Roth plan. Traditional plans are taxable whilst Roth plans are tax free.
- The beneficiary can also leave the money in the deceased's plan and withdraw it within 10 years.

Based on the above, the person who inherits the pension plan of the deceased is liable for the taxes on the account and whether tax is paid depends on whether the deceased had a traditional or Roth plan. For non-spousal beneficiaries, any money left in the account after ten years will be subject to a 50% tax penalty with exception to beneficiaries who are minors, disabled or chronically ill (Lake, 2023).

In conclusion, inheriting a Roth plan is advantageous and ideal for a non-spousal beneficiary as they enjoy a tax-free inheritance but for a limited period as they enjoy the tax-free status for 10 years until it incurs a significant tax penalty. This drives individuals to deplete the funds prematurely in attempt to dodge the tax penalty.

The Individual Retirement Account will be discussed next.

4.5.4 Individual Retirement Account (IRA)

In addition to the 401(k), 403(b) and 457 plans, there is an IRA that is a tax advantaged account designed to help individuals save for their retirement (Silberstein, 2024). Unlike employer sponsored plans, an IRA can be opened by anyone at a bank or other financial service providers and such individual can contribute to it subject to certain contribution limits (Adams, 2024b).

The IRA offers both traditional and Roth plans, which influence the tax implications of the funds upon withdrawal. In a traditional IRA, contributions are tax deductible but the withdrawals from the account are taxed as ordinary income (Silberstein, 2024). However, in a Roth IRA, contributions are not tax deductible as they are made from the post-tax income and withdrawals are tax free provided that the Roth IRA has been open for at least five years before withdrawal (Adams, 2024b). In 2024, individuals below 50 years old are subject to an annual contribution limit of \$7 000 whilst individuals above 50 years old are subject to an annual limit of \$8 000 (Silberstein, 2024).

IRAs are accessible when the individual reaches the age of 59.5 years and any withdrawal before that may incur an early withdrawal penalty of 10% (BlackRock, 2024). However, early withdrawals from a traditional IRA are allowed without a penalty if the withdrawal is for up to \$10,000 for a first-time home purchase, qualified education expenses, permanent disability, unreimbursed medical expenses exceeding 7.5% of adjusted gross income, health insurance premiums during unemployment of 12 or more weeks, or taking substantially equal periodic payments based on life expectancy (Fontinelle, 2024).

Withdrawals of contributions from a Roth IRA are allowed at any given point in time without a penalty (Fontinelle, 2024). However, should the member withdraw the earnings on the contributions before the age of 59.5 years, the withdrawal will be subject to the penalty with exception to, if the member becomes disabled or took the withdrawal to make a qualified first home purchase up to \$10 000 (Fontinelle, 2024).

When the individual turns 73 years old, they must withdraw the required minimum distribution amount from a traditional IRA (BlackRock, 2024). However, the required minimum distribution amount does not apply to Roth IRA's (BlackRock, 2024).

From the above discussion it was found that IRAs offer individuals with a flexible savings option as they can withdraw their contributions at any given time without a penalty. This would be ideal for Roth plans as money can be withdrawn tax-free at any given time especially for circumstances that require immediate access to money. The disadvantage of the flexibility to withdraw at any time with no penalty is that individuals can deplete their savings before actual retirement and be forced to rely on the social security especially if they have no other retirement plan in place.

A comparison of the tax implications of retirement funds between South Africa and the USA will be discussed next.

4.5.5 Comparison of the USA to South Africa

From the above discussions it was found that in the USA, the Social Security program mandates employees to contribute towards the social security complemented by the voluntary employer sponsored plans. However, South Africa does not have compulsory retirement funds wherein employees must participate unless they are mandated by their employment contract. Employer contributions to retirement funds are included in the taxable income of employees in South Africa whilst in the USA they are not included as employment income. Whilst employer contributions are included in the gross income, they are deductible subject to certain limits effectively making a portion of it tax-free.

In the USA, contributions to the social security are not tax deductible whilst in employer sponsored plans, the deductibility depends on the type of plan. Contributions to a traditional plan are made pre-tax which effectively lowers the taxable income whilst contributions made to a Roth account are made out of the post-tax income with no immediate tax deduction. However, in South Africa, contributions to retirement funds are deductible against the individual's income subject to a limit as set in section 11F of the ITA. Both South Africa and the USA exempts investment returns earned by the funds from tax until withdrawal.

Both countries impose age restrictions at which the retirement funds can be accessed without penalties. In the USA, the government normally sets the retirement age whilst in South Africa it depends on the rules of the specific retirement fund that the individual belongs to. At retirement, South African individuals are required to take out one-third of the retirement savings as a lump sum, with the remainder paid as a monthly annuity. However, in the USA, individuals have flexibility on how they can withdraw their money.

Social security benefits may be subject to tax up to 85% with the remaining 15% of the benefit being tax free depending on the individual's income levels. Withdrawals from traditional plans are taxed as ordinary income with no tax-free portion whilst withdrawals from Roth plans will be tax free. In South Africa, the first R550 000 of the retirement benefit will be tax free whilst the remaining portion is taxed using a separate progressive tax table. However, the first R27 500 of a withdrawal benefit is tax free whilst the remaining portion is taxed using a separate tax table that normally results in a higher tax compared to that retirement withdrawal benefit table.

In the United States, early withdrawal from a pension plan incurs a penalty of 10% unless specific conditions are met. Both countries impose heavy tax on early withdrawals before reaching retirement age to discourage individuals from cashing out their savings before retirement. Retirement annuities and two-pot payments that individuals receive are included in their taxable income and taxed using their marginal rate.

In the USA, the tax treatment of withdrawals depends on the type of retirement account. Withdrawals from traditional plans and IRAs are taxed as ordinary income at the individual's marginal tax rate. There is no tax-free lump sum withdrawal option as seen in South Africa. However, withdrawals from a Roth plan are tax free as the contributions were made post tax and no deduction was received. Upon death, both countries have the same provisions for transferring retirement benefits from the deceased to the beneficiaries.

In conclusion, the tax treatment of retirement funds in South Africa and the USA depicts similarities and notable differences. Both systems provide tax benefits during the contribution and accumulation phases, encouraging retirement savings and tax deductions during the contribution

phase. However, differences arose in the tax treatment of withdrawals as South Africa exempts a certain portion of a lump sum from tax. However, the entire retirement benefit can be tax free in the USA provided that it is a Roth plan. However, the USA's system provides more flexibility to individuals as they can choose whether to take out their savings as a lump sum or an annuity and the tax-free Roth plan incentivises individuals to save more for their retirement and manage their taxes effectively throughout their retirement.

4.6 Conclusion

This chapter analysed the tax treatment of retirement funds of the selected developed countries which was critical for the broader research topic that aimed to compare the tax treatment of South African retirement funds internationally. This analysis contributes to the main objective of benchmarking South Africa's tax provisions against those of the countries discussed in this chapter with the ultimate goal of identifying areas for possible recommendations. This chapter therefore addressed the secondary research objective as identified in par 1.5.2 (iii) and (iv).

It can be seen from the comparisons done above that each country has their own unique system with some similarities and differences. However, countries like Canada, USA and the UK have government administered pension plans that are mandatory, and individuals can voluntarily choose to join other plans to supplement their retirement savings.

The next chapter will provide a summary of the comparison, the findings thereof and demonstrate how the research objectives have been met. It will also provide recommendations on how the South African legislation can be amended based on the findings and possible future areas of further studies that can be performed.

CHAPTER 5: SUMMARY AND CONCLUSION

5.1 Introduction

This study addressed international comparisons of the tax treatment of South African retirement funds whilst compared to Australia, Canada, the UK, and the USA. Chapter 1 introduced the study, providing background and context regarding retirement funds in South Africa and highlighting the relevance of the topic.

The problem statement and research objectives were clearly defined, and the appropriate research methodology addressed the objectives that were identified. The research for this mini-dissertation was conducted through a literature review of existing sources, including tax legislation from South Africa, Australia, Canada, the UK, and the USA. Additionally, primary resources such as books, journal articles, and online articles were analysed. This was a qualitative research study hence, no quantitative data was collected or utilised. The sources used were interpreted to derive conclusions.

The purpose of this chapter is to conclude the study by summarising how the problem statement and research objectives were addressed through key findings. It provides recommendations or suggestions relevant to the South African context and provides recommendations for future research in this field.

5.2 Research objectives

The main objective of the study in response of the research question was to determine how the income tax implications of funds received at early access to the funds and at retirement, resignation and death differ between South Africa, Australia, Canada, the UK, and the USA in order to benchmark the South African tax provisions of retirement funds for possible recommendations. The tax implications at different triggering events being early access, retirement, resignation, and death were discussed and considered from a South African tax perspective.

In considering the benchmarking of the South African tax treatment, an analysis of the tax treatment of retirement funds of Australia, Canada, the UK, and the USA was done. A comparison of the tax treatment was also done to determine similarities or differences in tax treatments of retirement funds at early access, retirement, resignation and death of the selected countries when compared to that of South Africa.

To address the main objective of the study, secondary objectives were set in Chapter 1. The first secondary objective was to analyse the development in the taxation of retirement funds from 1994 to date. This objective was addressed in Chapter 2. The second secondary objective was to analyse what the South African proposed two-pot entails and the tax implications thereof. This objective was addressed in Chapter 3. The third secondary objective was to analyse the income tax treatment of retirement funds at early access to the funds and at retirement and resignation of Australia, Canada, the UK, and the USA. This objective was addressed in Chapter 4. The fourth and final secondary objective was to identify differences between the income tax treatment between South Africa and the selected developed countries. This objective was addressed in Chapter 4.

5.2.1 Secondary objective i

The secondary objective was successfully addressed as all developments relating to the taxation of South African retirement funds were appropriately analysed. Chapter 2 analysed the significant changes in the South Africa's taxation of retirement funds post 1994. The introduction of the retirement fund tax and its subsequent abolition to encourage savings was discussed together with the equalization of tax treatment for public and private sector funds. It detailed the simplification of the taxation of retirement and withdrawal lump sum benefits, the harmonization of tax deductibility for contributions across different funds, and the annuitisation requirements for provident funds.

The chapter concluded with an overview of the two-pot retirement system, that allow early access to retirement savings while preserving funds for retirement, marking a significant development in response to the economic impact of the Covid-19 pandemic and post-Covid-19. The two-pot retirement system remains crucial post-Covid-19 as it balances financial flexibility with long-term retirement security and addressing ongoing economic uncertainties.

5.2.2 Secondary objective ii

The objective was to analyse the proposed two-pot retirement system in South Africa and the tax implications thereof and it was successfully addressed as the analysis provided a comprehensive overview of the structure and tax treatments of the two-pot retirement system. The discussion outlined the introduction of the system in response to the Covid-19 pandemic and the need for early access in times of financial distress.

It detailed how the system divides retirement savings into two components, namely the savings pot and the retirement pot. A savings pot allows one annual withdrawal with a minimum of R2 000, and a retirement pot remains preserved until retirement. The tax treatment of the pots

was explained, with withdrawals from the savings pot included in a member's taxable income and taxed according to the marginal tax rates.

At retirement, the remaining balance in the savings pot will be paid out as a lump sum and subject to the retirement lump sum tax tables. However, the retirement pot will be paid out in the form of an annuity, and this will be included in the individual's taxable income and taxed according to the marginal rates in the normal tax tables.

5.2.3 Secondary objective iii

The analysis of the income tax treatment of retirement funds at early access, retirement, and resignation in Australia, Canada, the USA, and the UK was the focus of the third objective. This objective was addressed in Chapter 4, where the study analysed the tax implications of retirement funds across the jurisdictions. The study sheds light on the unique features of each country's system, such as Australia's compulsory superannuation system, the differential treatment of the traditional and Roth plans in the USA, and the role of National Insurance contributions in determining the UK's state pension.

5.2.4 Secondary objective iv

The fourth objective was to compare the income tax treatment of retirement funds between South Africa and the selected developed countries in order to identify differences. This secondary objective was successfully addressed, as Chapter 4 compares the income tax implications of retirement funds in Australia, Canada, the USA, and the UK with South Africa's system, analysing early access, resignation, death, and retirement scenarios. It provided a detailed examination of each country's retirement fund structures, tax treatments, and highlighted the differences and similarities to South Africa's approach.

The below discussion and comparison of the findings and the summary thereof in Table 5-1 illustrates the similarities and differences of the tax treatment of the retirement funds of each country.

5.3 Comparison of the implications of the various triggering events

5.3.1 Early Access

In South Africa, post 1 September 2024, individuals can withdraw a minimum of R2 000 from the savings pot once a year for their personal needs. The withdrawal will be included in the individual's gross income and taxed according to the marginal tax rates. In Australia, it is illegal for employees to withdraw from their super (a fund similar to a South African retirement fund) before reaching preservation age. However, individuals can access their funds on a compassionate ground such

as severe financial hardship. Should an Australian natural person get permission, the amount withdrawn will be taxed using the marginal tax rate of the natural person. Canada allows withdrawals before a natural person reaches the age of 55 years only in exceptional circumstances which include but not limited to when the individual has a low income, inability to pay house and when the home is up for repossession. South Africa, Australia, and Canada tax the early access amount using the natural person's marginal tax rate.

Early access in the UK is only allowed if the employee is accessing it due to ill health or due to a protected retirement age. In the USA, early access is only allowed if the individual is facing financial hardships. It is evident from the above that South Africa, post 1 September 2024, is the only country from the countries selected for the comparison that allows individuals to access a portion of their retirement savings throughout their working years for emergencies whilst early access in other countries simply means accessing the retirement savings before the set retirement year due to exceptional circumstances. With the amended regulations in South Africa, individuals will not be able to access the retirement pot of the two-pot retirement system without reaching retirement age by simply resigning from employment as what was possible before the introduction of the two-pot retirement system pre-1 September 2024.

In terms of early access, South Africa provides the most flexibility solution compared to the other countries, without eroding all retirement savings before retirement or death. Australia, Canada, UK, and USA have strict rules that only allow access if specific circumstances are met.

5.3.2 Retirement

In South Africa, individuals who retired and had any retirement funds before 1 September 2024, that had a vested component had a choice to take either one third as a lump sum or receive the entire amount as an annuity (taking into account the *de minimis* rule which was discussed in Chapter 2.7). The one third of the vested component received as a lump sum, will be taxed according to the special retirement lump sum tax table that exempts the first R550 000 of all aggregate lump sums received past 1 March 2009 from tax. The remainder of the fund, not taken as a lump sum, will be received as an annuity and included in the gross income of the individual and taxed using the marginal tax tables. For individuals who joined after 1 September 2024, any remaining balance of the savings pot will be paid out as a lump sum, if selected as such by the member of the fund and will be taxed using the retirement lump sum tax table that exempts the first R550 000. The retirement pot will be paid out as an annuity and be taxed using the marginal tax tables.

In Australia, the income tax depends on whether the employee receive their savings as a lump sum or income stream, whether it's a taxable or tax-free component and the age of the individual.

No tax is payable on the tax-free component and the tax on taxable component is either a fixed percentage or the marginal rate depending on the various circumstances (as discussed in Chapter 4.1). Retirement payouts of CPP, RPP and RRSP and are considered as income in Canada and are taxed according to the individual's marginal rate. The UK allows up to 25% tax-free on the pension savings and the remaining 75% is taxed using the individual income tax rates. In the USA, a certain portion of the social security payout is tax-free provided that the income does not exceed a certain threshold (as discussed in Chapter 4.5.2). The remaining taxable portion is taxed according to the marginal tax rates that depend on the filing status of the individual and the total income. The tax implications of employer sponsored plans depend on whether the plan is a Roth or a traditional plan. Withdrawals from Roth plans (USA employer sponsored plans) are tax-free whilst withdrawals from USA traditional employer sponsored plans are subject to tax according to the marginal tax rates.

In conclusion, South Africa, Australia, UK and USA tax systems are more comparable as they exempt a portion of the retirement benefit and tax the remaining portion which provides individuals with more disposable income to spend in their retirement. However, the USA tax system, provided it's a Roth plan, stands out as the most beneficial for individual as the entire retirement savings will be tax-free.

5.3.3 Resignation from employment

In South Africa, individuals who had retirement funds (only pension or provident related to employment) and resigned from their employment before 1 September 2024, were able to access the full value of the vested component and savings component of the fund. The entire vested component and the remaining balance of the savings pot could be received as a lump sum, if selected, and the lump sum were taxed according to the special retirement withdrawal lump sum tax table that exempted the first R27 500 of the aggregate of all lump sums received past 1 March 2009 from tax and taxes the rest using a sliding scale. Post 1 September 2024, and with the introduction of the two-pot retirement plan, the retirement pot will not be accessible until the individual reaches retirement as agreed in terms of the contract of the retirement plan.

It is illegal in Australia for individuals to access their savings before retirement and individuals cannot access their retirement savings legally when they resign. In Canada, individuals cannot withdraw from their CPP, RPP when they resign. Canadians can however withdraw from the RRSP, and such withdrawal will be taxed using the federal income tax rates. In the UK, resignation is not a condition to access either the UK Pension system or the private pensions funds. The UK pension will remain invested until retirement age is reached. In the USA, individuals cannot access the social security when they resign but can access the employer sponsored plans called 401(k), 403(b) with a 10% penalty.

In conclusion, South Africa, Australia and the UK are comparable as resignation is not a condition of access and individuals are not able to access the retirement savings if they resign. This comes after legislation changes in South Africa wherein individuals who join retirement funds after 1 September 2024 will not be able to access their retirement pot until retirement. The USA penalizes individuals more as they are taxed on their ordinary rates and together with a 10% penalty. South Africa's system seems to be beneficial particularly for individuals who had retirement funds before 1 September 2024 as a portion of the resignation benefit will be tax-free. South Africa is the only country that exempts a certain portion of the resignation benefit providing individuals with a lesser tax burden.

5.3.4 Death

In South Africa, the retirement savings of the deceased are deemed to accrue to the deceased the day before their death and is taxed in the deceased's last income tax return using the retirement lump sum tax table. Effectively, the lump sum death benefit is tax-free in the hands of the beneficiary as the taxes are already paid by the deceased, but annuities received by the beneficiaries will be included in gross income payable using the marginal tax rate.

In Australia, no tax is payable if the death benefit is paid over to a dependant of the deceased in a form of a lump sum. However, if the benefit is paid over as an income stream, no tax is payable if the dependant is over the age of 60. If under the age of 60, tax will be payable using the marginal tax rate. For benefits paid over to a non-dependant of the deceased, these will be subject to tax of 17% for the taxed element and 32% of the untaxed element. Death payouts of the CPP are not taxable provided that they are used to cover the funeral costs of the deceased.

In Canada, if the death benefit of a RRSP or RRIF is paid over to a qualifying beneficiary, it will be taxed in the hands of a qualifying beneficiary. However, if it is paid over to a non-qualifying beneficiary, it is taxed in the hands of the deceased and its effectively tax-free in the hands of a non-qualifying beneficiary. For RPP death benefits, the death benefit is taxed in the hands of the beneficiary. In the UK, beneficiaries do not pay tax on the death benefit provided the deceased died before the age of 75. However, if the deceased died aged 75 or over, the beneficiaries will be taxed on the death benefit.

In the USA, Social Security death benefits can be taxable in the hands on the beneficiary depending on their filing status and income. However, for USA employer sponsored plans, if the death benefit is paid over to the spouse, it will be treated as ordinary income and taxed according to the spouse's tax bracket. However, if paid over to a non-spousal beneficiary, the tax implications will depend on the type of the deceased's plan. If it was a Roth plan, the beneficiary

will not be liable and if it was a traditional plan, the beneficiary will be liable for tax using their marginal tax rate.

In conclusion, the tax treatment at death between South Africa, Australia, Canada, UK and the USA presents both similarities and differences. The tax systems of all countries present an opportunity for the beneficiaries to receive the death benefits tax-free provided certain conditions are met. South Africa stands out as the most favourable tax treatment due to its straightforward policy that does not impose stricter conditions like beneficiaries' relationship to deceased, age of deceased like in the other countries. The below table provides a summary of the tax implications of the different events for the different countries.

Table 5-1: A comparison of the tax implications of retirement funds of South Africa and the selected countries

Country	South Africa	Australia	Canada	UK	USA
Contributions	Deductible subject to limitations in terms of s11F of ITA.	Taxable depending on whether there are concessional contributions or non-concessional contributions. Non concessional contributions are not taxable whilst concessional contributions are subject to 15% tax.	Employee contributions to the CPP are tax deductible at the lowest tax rate of 15%. Employee contributions to RPP and RRSP are fully deductible.	Employees do not receive any deduction of the National Insurance contribution. Tax relief is available at the highest rate of income tax applicable to the employee for contributions to private pensions.	Contributions to social security are not tax deductible. However, for self-employed individuals, the employer contribution equivalent portion is allowed as a deduction. Contributions to a traditional plan are made pre-tax which effectively lowers the taxable income whilst contributions made to a Roth account are made out of the post-tax income with no immediate tax deduction.
Investment growth	Investment growth is exempt from tax.	Investment growth is taxed at 15% flat rate.	Investment growth in the fund is not subject to tax.	Investment growth in the fund is not subject to tax.	Investment growth in the fund is not subject to tax.
Retirement	Individuals with pension before 1 September 2024: Lump sums taxed according to the retirement lump sum table with the first R550 000 tax exempt. The annuity is taxed according to the normal tax tables. Individuals with pension after 1 September 2024: Annual withdrawals from the savings pot will be included in the taxable income and tax calculated using the marginal tax rates.	Withdrawals for individuals who are 60 years and above are tax-free. Individuals below age 60, their benefits will be subject to tax at a flat rate or 0% depending on whether the amount is from the taxed element or untaxed element, withdrawal type and the caps. The super has a tax-free portion which is exempt from tax.	Withdrawals are fully taxable as ordinary income.	25% of the pension pot is tax free and the rest is taxed according to the standard income tax tables.	Up to 85% of the social security benefit may be subject to tax depending on the income levels. 15% of the social security will be tax-free. Withdrawals from traditional plans or IRA are taxable according to the marginal tax rates. Withdrawals from Roth plans are tax-free.

	Any savings remaining in the savings pot at retirement will be taxed according to the retirement lump sum tax table with the first R550 000 tax free. The retirement pot will be paid out in the form of a monthly annuity and will be taxed using the normal tax table.				
Early access	Withdrawals from the two-pot are included in the individual's gross income and taxed using the individual's marginal rates.	Funds accessed on a compassionate ground are taxed on the individual's marginal rate	Funds accessed early are taxed on using the individual's marginal rate.	Withdrawals will be taxed using the individual's rate of tax which depends on their earnings.	The early withdrawal amount from the traditional plan will be taxed using the individual's marginal rate. However, Roth plan withdrawals are tax free. An early withdrawal penalty may be levied over and above the ordinary tax.
Resignation	The first R27 500 of the withdrawal benefit will be tax-free whilst the remaining amount will be taxed using the retirement withdrawal lump benefit tax table which uses marginal rates.	Resignation is not a condition of access.	Withdrawals from the RRSP are taxed according to the federal income tax rates.	Resignation is not a condition of access.	The withdrawal amount from the traditional plan will be taxed using the individual's marginal rate. However, Roth plan withdrawals are tax free. A withdrawal penalty of 10% may be levied over and above the ordinary tax.
Death	If the beneficiary takes the benefit as a lump sum, the tax is paid by the deceased, and the beneficiary receives the after-tax amount. If the beneficiary takes out the benefit as an annuity, the annuity is included in their gross income and taxed using their marginal tax rates.	No tax is payable provided the death benefit is paid over as a lump sum. Income stream benefits are tax-free if the dependent is over 60 otherwise tax is payable at the marginal rate.	RRSP or RRIF death benefits paid over to a non-qualifying beneficiary are tax-free whilst the ones paid to a qualifying beneficiary are taxed in their hands. RPP death benefits are taxable in the hands of the beneficiary.	Death benefits are tax-free if the deceased was under 75, otherwise the beneficiaries are taxed.	Social Security death benefits can be taxable depending on the filing status and income of the beneficiary while employer sponsored plans benefits are taxable at the beneficiary's marginal rate if from a traditional plan, but tax-free if from a Roth plan.

Source: Author's compilation of information presented in the above Chapters

5.4 Recommendations

The following recommendations are made to make the South African retirement system more effective and fairer based on the comparison done between the tax implications of Australia, Canada, the UK, and the USA:

- South Africa could introduce a government sponsored pension fund that is compulsory to all employees similar to the CPP, USA social security and the UK National Insurance. This would ensure that employees benefit from their contributions, as most of the individuals do not qualify for the old age grant due to the means test. However, individuals are indirectly funding the old age subsidy through taxes, but they do not receive the benefit which is unfair as it places a financial burden on taxpayers without providing them a safety net in their retirement years. Implementing a government sponsored pension plan that is compulsory for all employees would ensure that their contributions benefit them during retirement.
- South Africa could provide employees with the flexibility of choosing how they wish to withdraw from their retirement savings and move away from the compulsory annuitisation. For individuals who joined pension funds after 1 September 2024, should they withdraw all the money from the savings pot before retirement, they will not receive a lump sum at retirement as the retirement pot is only accessible in the form of a monthly annuity. Therefore, individuals should be provided with the flexibility and choice of how to receive their savings to allow them to make informed decisions based on their financial needs and circumstances and give them greater control on how they can manage their funds like in other countries.

5.5 Areas of future study

With the latest amendment in legislation to include the two-pot retirement system, more studies can be done on the South African two-pot retirement system. A more in-depth study can be performed on the effectiveness of the two-pot retirement system by assessing whether the system has reduced pre-retirement withdrawals from retirement savings and whether individuals are better prepared for retirement as a result of this reform.

This can be done by examining data from withdrawals trends. A study can also be conducted on the long-term impact of the two-pot retirement system withdrawals on the adequacy of retirement savings. Furthermore, a study on how individuals are using their savings pot withdrawals, to determine if they are withdrawing only for genuine emergencies, or has it led to a pattern of frequent withdrawals for non-essential reasons. With public speculations that the two-pot was a

ploy by SARS and National Treasury to increase tax collection, a study could be conducted on the tax revenue implications of the system. This would involve analysing whether the two-pot retirement system has led to a significant increase in tax revenues compared to the previous system.

5.6 Conclusion

The study focused on comparing the tax implications of retirement funds in South Africa to Australia, Canada, the UK, and the USA in order to identify gaps and recommend improvements to the South African government on how to enhance the effectiveness and fairness of the retirement system ensuring sufficient retirement savings and long-term financial security for its citizens.

It was found that South Africa's retirement system is to some degree comparable to the selected countries as similar tax approaches have been adopted. However, South Africa lacks flexibility in how individuals can withdraw their retirement savings due to the mandatory annuitization. This shows that other countries provide greater freedom of withdrawal options. A summary of the findings is provided in Table 5-1 above.

Based on the findings, South Africa's retirement tax is more favourable as it provides individuals with deductions on their contributions, exempts growth and provides individuals with an exemption on the lump sum benefit. The South African system also uses a favourable tax table to determine the tax for retirement fund lump sums whilst other countries use the marginal tax tables which will effectively lead to a higher tax as the retirement lump sum will push the taxable income to a higher bracket resulting in a high tax rate to be applied.

In conclusion, the South African legislation is largely aligned to that of the selected developed countries and only minimal changes may be necessary to make the system even more effective, fair and beneficial for the individuals. Based on this comparison, it is clear that the South African retirement system compared well with the selected countries, meaning there are limited recommendations as the system already demonstrates a strong alignment.

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