

Important considerations when changing jobs

It is accepted that workers are likely to change employers more often than 50 years ago. Labour has become more flexible and mobile. The labour market is also increasingly becoming more competitive as companies want to attract the best talent. Employment may also be terminated due to redundancy and dismissal. As a result, change of jobs, for whatever reason, comes with considerable temptation to withdraw retirement savings. Nonetheless, the need to provide for retirement does not go away.

Numerous studies have shown that it is very difficult to make up for any early withdrawal of retirement savings even if you are decades away from retirement. This is because of additional financial responsibilities workers take on during as they progress through their working life including children's education, housing, etc. You will also be very unlikely to be able to catch up with the benefit of compounding over time of investment returns. Therefore, early withdrawal may lead to frustration and anguish at the end of your working life when you discover that your retirement provision is insufficient to provide a satisfactory pension. It is very important to fully understand and evaluate the implications of your retirement fund options when changing jobs.

Key implications of early withdrawal:

- You may incur tax to be deducted from the cash benefit amount
You will pay tax on lump sum withdrawals in terms of the Income Tax Act. Any withdrawal benefit above R25 000 will attract tax. The first R25 000 exemption applies only once. Prior withdrawal lump sum benefits are taken into account in determining your tax liability each time you withdraw from a retirement fund, i.e. there is aggregation. The rate of tax ranges from 18% to 36% depending on the aggregate amount of your lump sum retirement fund withdrawals as indicated in the Table below.

| Taxable income from lump sum benefits | Rate of tax |
|---------------------------------------|--|
| 0 – R25 000 | 0% of taxable income |
| R25 001 – R660 000 | 18% of taxable income above R25 000 |
| R660 000 – R990 000 | R114 300 plus 27% of taxable income above R660 000 |
| R990 001 and above | R203 400 plus 36% of taxable income above R990 000 |

- You reduce your tax-free allowance on the permissible lump sum benefit at eventual retirement
The first R500 000 of the permissible lump sum benefit at retirement is exempt from tax. However, any previous lump sum withdrawal benefits received from your retirement fund serve to reduce this tax-free allowance. You may therefore have to pay tax on the entire lump sum benefit at retirement. The rate of tax on retirement lump sum benefits ranges from 18% to 36% as indicated in the Table below.

| Taxable lump sum (R) | Rate of tax |
|----------------------|---|
| 0 - 500 000 | 0% of amount |
| 500 001 - 700 000 | R0 + 18% of amount exceeding R500 000 |
| 700 001 - 1 050 000 | R36 000 + 27% of amount exceeding R700 000 |
| 1 050 001 and above | R130 500 + 36% of amount exceeding R1 050 000 |



- You lose out on the effect of compounding of investment returns.
Your retirement savings earn investment returns each year. These returns are reinvested and they also earn returns. This means your savings and their returns are working to your advantage at the same time. The longer you remain invested, the faster is the growth of your savings due to compounding.

Available options

When you leave service of your employer participating under the Central Provident Fund, you will receive documentation about various options relating to retirement savings. We summarise your options and provide its advantages, disadvantages and tax implications below.

| Option | Advantages | Disadvantages | Tax implications |
|--|---|--|--|
| Become a paid-up member and leave benefit in the fund (default preservation strategy) | Your benefit is preserved until you retire. | None | No tax. |
| Transfer to your new employer's retirement fund | Your benefit will be preserved until you retire. | You cannot access the benefit unless your membership under the new fund is terminated. | No tax. |
| Transfer to preservation provident fund | Your benefit will be preserved until you retire. You are allowed one withdrawal at any time and leave the rest for retirement (subject to tax). | None | No tax. |
| Cash lump sum | You will have access to cash. | You will have to start saving for your retirement all over again. You may never be in a position to catch up and may not retire comfortably. | The lump sum benefit is taxable . |

Default Preservation Strategy

If you leave service of your employer and fail to notify the administrator (Sanlam Life) of your choice among the options mentioned above, you will automatically become a paid-up member of the fund. This is the **Default Preservation Strategy** adopted by Board of Trustees of the Central Provident Fund in line with Regulation 38 of the Pension Funds Act. Your savings will be preserved in the fund for as long as you need. You will also receive a certificate to confirm your paid-up membership status.



Let's consider Thuli

She is 35 years old and has been working for ABC Company for the past 10 years. She is currently a member of ABC Provident Fund sponsored by Company A and has already accumulated R223 000. She gets a better opportunity and benefits with Company XYZ and decides to leave Company ABC. As a condition of service, Company XYZ requires Thuli to be a member of their XYZ Provident Fund. She stays with Company XYZ for the next 25 years until her retirement at age 60.

Scenario 1

Thuli decides to preserve the entire benefit by transferring it to her new employer's XYZ Provident Fund. No tax is payable on the transfer and her retirement savings remain intact.

She manages to accumulate total retirement savings of **R6.3m** in the new XYZ Provident Fund by retirement at age 60. She decides to cash in R500 000 of her accumulated provident fund savings and use the rest (R5.8m) to buy a pension. Since she has never received cash withdrawal benefits in the past from a retirement fund, the entire R500 000 retirement lump sum benefit is tax-free.

Scenario 2

Thuli withdraws her entire retirement savings of R223 000 from ABC Provident Fund on changing jobs at age 35. The first R25 000 of the lump sum withdrawal is exempt from tax. Therefore, she pays tax of about R36 000 (at a rate of 18%) on the excess of the withdrawal benefit above R25 000. She therefore gets only about R187 000 after tax and will have to start saving for retirement all over again at age 35.

Her retirement savings under XYZ provident Fund eventually accumulate to **R4.1m** by age 60. She also decides to cash in R500 000 as a lump sum retirement benefit and uses the rest to buy a pension.

As the sum of lump sum benefits previously received (R223 000 from her previous employer's ABC Provident Fund) plus the retirement lump sum benefit (R500 000) exceed the R500 000 tax-free allowance, she will be required to pay tax at retirement. Total amount of lump sum benefit accrued is R723 000. Her total tax liability will be about R42 000 at retirement such that her net lump sum benefit at retirement is R458 000.

Benefits of preservation

In Scenario 1, Thuli has R2.2m more wealth at retirement compared to Scenario 2. She does this by simply preserving her retirement savings on change of jobs. She avoids tax payable on early withdrawal of retirement savings and keeps her tax-free allowance on lump retirement benefit.



The additional wealth at retirement gained through preservation is almost 10 times her accumulated savings when she changed jobs. This is confirmation of the powerful effect of compounding of investment growth for savings for a long period.

Get assistance

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