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WHY ARE PENSIONERS TAXED? By Jonathan Hore

Thato has been working for a couple of decades now and he is due for retirement. As a soon-to-be senior citizen, Thato believes that he should not suffer tax on the pension commutation that he will soon receive upon retirement. He is of the view that he has been contributing his fair share of taxes ever since he started working. As such, he is so expectant that he will get his pension intact without paying any thebe to the taxman. You would agree with Thato, right? I mean, this fella has contributed to the construction of government schools, clinics and hospitals and the taxman better gives him a break; at least seeing that he will soon be a senior citizen. Why would the taxman still want to tax this old fella who will soon be living on a smaller amount of income from his previous pension contributions? Well, I will discuss the taxation of pensions in this article hoping that it will be insightful. Words importing the masculine shall be deemed to include the feminine.

MONTHLY PENSION CONTRIBUTIONS

Let me take you step by step and expand on how our monthly tax contributions are treated for tax purposes. There are basically two types of pension funds, being approved and unapproved pension funds. Approved funds are those which are registered in Botswana and also approved for tax purposes by BURS. The effect of this is that when employees make contributions to such pension funds, their salaries or taxable income is first reduced by the amount of the pension contributions. Technically, the pension contributions result in any taxpayer paying less tax on a monthly basis, to the extent of the pension contribution. To make this simple, let us assume that Thato has been earning P 34 000 per month and making monthly pension contributions of P 2 000 to an approved pension fund. This means that Thato will only be taxed on P 32 000, being P 34 000 less the P 2 000 that he contributes to the fund.

I hope that makes it clear that a pension contribution to an approved pension fund results in tax savings. One thing to note on this aspect is the fact that the pension contributions should not exceed 15% of the income of the taxpayer. I shall not dwell much on this aspect as most contributions do not exceed the stated percentage.

So does it mean that contributions to an unapproved pension fund are not tax deductible? The answer to that is a big 'Yes!' Effectively, the employee will be taxed on his total earnings as if he did not make any contributions to the pension fund.

IS THE PENSION TAXED 100%?

Well, simply because the taxman allowed you to reduce your taxable income whilst you were working, you actually made tax savings. This therefore means that pension payments made to Thato from the approved pension funds should naturally suffer tax when the pension funds pays him on retirement. Most pensioners opt to get a lump-sum of their pension as a once-off payment and then get monthly payments, to sustain them thereafter. The lump-sum payment is alternatively called a 'commutation of a pension' and the good news is that it enjoys 33.33% tax exemption. This means that if Thato is entitled to a pension of P 800 000 and commutes P 450 000, the first 33.33% of the P 450 000 escapes tax and the remaining 66.67% suffers tax. In fact, Thato is taxed because he enjoyed tax savings during the time he contributed to the pension funds. Above that, Thato gets a 33.33% exemption on the commutation. So technically, the taxman has been so kind to Thato in two ways, by allowing him to reduce tax during periods of contributions and also by giving him the 33.33% exemption. I should also state that the commutation of an amount from an unapproved pension fund should not suffer tax as the employee/taxpayer does not get a tax deduction at the time of contribution.

WHAT ABOUT MONTHLY PENSION RECEIPTS?

Well, I think it is now clear that Thato has received give-backs from the taxman on both the monthly contributions as well as the commutation he will soon receive. But will Thato still have to pay tax on the monthly payments that he will receive? Yes, Thato will still have to suffer tax on the pension payments he will receive on a monthly basis. You may want to know that the tax that employees suffer is called PAYE and it is governed by section 56 as read with the Fifth Schedule to the Income Tax Act. For your information, the Fifth Schedule defines an 'employee,' who is supposed to suffer PAYE as including a pensioner receiving such amount from an approved pension fund. This explains why Thato will still have the pension fund to which his employer directed his pension contributions to. The pension fund is still required to issue Thato with an ITW 8, as Thato is an employee. However, tax will only be deducted if the monthly pension contributions are in excess of P 3 000 per month, just like any other employee.

Well folks, I hope that was insightful. As Yours Truly says goodbye, remember to pay to Caesar what belongs to him.