What are the consequences of withdrawing from your retirement savings?

Reader's questions answered.

Patrick Cairns | 11 June 2015

CAPE TOWN – In this advice column Mikayla Collins from NFB Private Wealth answers a question from a reader who wants to withdraw some of her pension savings to fund her studies.

Q: I am resigning at the end of this year. Should my company transfer my pension funds straight into my account or is there another way? I'm asking because I want to use a quarter of the funds to pay for my study fees and then access the rest during the course of next year to avoid spending it unwisely.

To summarise your needs, you need a quarter of the funds immediately, and possibly a monthly income or to make ad hoc withdrawals down the line.

The first thing you need to do is clarify whether your money is in a pension fund or a provident fund, and what the maximum allowed withdrawal is. This is important because if it is a pension fund, you may only be allowed to withdraw a maximum of one third from the fund as cash, or the fund rules may even not allow any withdrawal at all prior to your turning 55. If it is a provident fund, it is likely that you can take out everything.

However, that doesn't mean that you should withdraw as much as you can get. On the contrary, you should think very hard about taking anything at all.

What is very important to bear in mind is that there are hefty tax implications to withdrawing from your retirement savings before you retire. For a start, you will be taxed on the money you take out now. Because you are resigning, the withdrawal table will apply, and for the 2016 tax year, this is as follows:

Taxable portion of withdrawal:	**Tax rate:**
R 0 – R 25 000	Nil
R 25 001 – R 660 000	18% of the amount over R25 000
R 660 001 – R 990 000	R 114 300 + 27% of the amount over R660 000
R 990 001 +	R 203 400 + 36% of the amount over R990 000

The second vital thing to understand is that the above table is cumulative over your lifetime. That means that if you have taken any other withdrawals from retirement funds since March 1 2009, these will be included when calculating the tax of any withdrawal – both now and in the future. To put it simply, that means that the more you take in withdrawals, the higher the percentage at which each one is taxed.

Another crucial consideration is that time is the most precious commodity you have when saving for retirement. The longer the growth on your money has to compound, the better the end result will be.

By taking a withdrawal now, you are therefore making it that much harder to reach your savings goals. The amounts may seem small now, but compounded over 30 or 40 years, they could make a very big impact on your financial position.

It's difficult to appreciate these long term effects when you are dealing with the short term need of funding your studies, but you have to weigh these up. By dipping into your retirement funds you are effectively borrowing from your future self at a very high interest rate, and you will possibly never be able pay back that loan.

If however you decide that you must make the withdrawal, I would urge you to only draw the quarter you need for your studies. You mentioned that you want to avoid spending it unwisely, so to avoid that temptation the best thing to do is to leave what you don't need in the pension fund if that is an option, or move it into a preservation fund.

The money that you 'preserve' in this way will not attract any tax or affect the amounts you can withdraw tax free at retirement. It will also not preclude you from accessing one more withdrawal at a later stage.

Hopefully you won't need to do that, but knowing you can only make one more withdrawal will also make you consider very carefully how much you really need.

My suggestion is that you pay for your study fees now and then try and get a part time job or some source of income while studying so that you do not need to withdraw more from your preservation fund, or can withdraw a smaller amount. In addition, if you are able to get a job in the relevant field, the years of experience that you stand to gain when working while studying is invaluable and will also assist you in applying your studies practically.

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