K5,000) is K160,000.
The total tax payable (using annual PAYE rates) is K6,600.
Therefore: the appropriate rate of tax is 6600/160,000 = 0.04125 = 0.04
Therefore: the tax on the terminal benefit is 0.04*K160,000 = K6,400

4. Other Terminal Payments

a. Severance Pay

According to the 1st Schedule of the Taxation Act, paragraph (ra) up to K50,000 of any amount paid by an employer to an employee who has been declared redundant or retrenched is exempted from tax. Currently, the rest is taxed at 30 percent.

b. Gratuity

During the 2010/2011 Budget Statement, Section 16 of the Taxation Act was amended to remove any tax free contract gratuity. Hence, the total amount of contract gratuity is taxed at the highest rate of 30 percent.

c. Notice Pay

According to the Taxation Act, Section 17 paragraph (1) notice pay shall be fully taxed at the highest rate of 30 percent because it is not-

I. An annuity;
II. A payment in commutation of a pension made from a pension fund or from the public funds of the Government;
III. A payment on account of ill health or disability
IV. A payment from a pension fund withdrawal as a way of terminal benefit; or
V. An amount received by or accrued to an employee from provident fund.

d. Leave Pay

Section 17 paragraph (2) of the Taxation Act stipulates that a single terminal payment to an employee in lieu of paid leave shall assessed to tax as if such leave had been taken by the employee immediately after the cessation of the employment and he had been paid accordingly. And the tax rate to be used is 30 percent.

Regulations

Since according to PAYE Information rules all the above payments are remunerations, all regulations that guide the operation of PAYE shall apply especially in terms deduction and payment rules and their penalties.

Conclusion

It is our conviction that the introduction of self assessment system on pensions and terminal benefits will remove the red tape in terms of tax calculations and remittances and payments to beneficiaries whilst strongly guarding against the abuse of the system.

NOTICE

The Law relating to Tax Calculation on Pension and Terminal Benefits is Taxation Act. The information in this brochure is not intended to be a legal interpretation of the Act (regulations made there under) nor does it override any provision thereof.

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MALAWI REVENUE AUTHORITY

Malawi Revenue Authority

Tax Calculation on Pensions and Terminal Benefits 2011/2012

Background Inlformation

In 2009, the Malawi Revenue Authority introduced the self assessment tax administration system where taxpayers, rather than MRA are empowered to take responsibility for calculating their own tax liabilities and submitting tax returns to MRA. It is against this background that tax assessment of pensions and terminal benefits should also be embraced in the self assessment tax administration system.

The only assessments that will be issued by MRA will be on reconciliation and audit and inspection where errors of underdeduction, underpayment and non-deduction will be uncovered. In this regard, administrators of pension funds and Human Resource Managers are encouraged to keep proper records pertaining to number of members of the pension fund, contributions by the members and their employer, bonuses and interests that have accrued to them, the amount of terminal benefits provided to those persons who have withdrawn and any severance pay, notice pay and contract gratuity payable.

Hence, the purpose of this presentation is to transfer skills and responsibilities in calculating tax for all persons who either retire or withdrawal from the pension fund. The presentation will mainly focus on the following four areas:

1. The role of the Commissioner General on pension funds.
2. The tax structure for pensioners.
3. The taxation of withdrawals from the pension fund
4. Other terminal payments

1. The role of the Commissioner General on Pension Funds

According to the Third Schedule of the Taxation Act, The Commissioner General will approve a pension fund for tax purposes if the following conditions are

Tax Calculation on Pensions and Terminal Benefits

met-

a. The fund is a permanent fund genuinely established for the purposes of providing annuities for employees on retirement from employment or for widows, children, dependants or nominees of deceased employees ; and
b. Either the fund was regarded or approved as duly established pension fund under any previous law or the fund is one whose rules provide-
   i. That all current annual contributions to the fund shall be in accordance with specified scales;
   ii. That employment shall be a condition of membership;
   iii. That an employee may be admitted to the pension fund within a period of 12 months after making an application;
   iv. That a maximum of one third of the total value of the annuity to which an employee is entitled may be commuted for a single payment except where the amount does not exceed K120,000;
   v. That except in the case of the Government or local authority, the employer shall not be involved in the administration of the fund and in deriving any monetary advantage from the fund; and
   vi. That the Commissioner General shall be notified of all amendments of the rules; and
c. The rules of the fund have been complied with.

2. The Tax Structure for Pensions

Once the Commissioner General has approved a pension fund upon being satisfied that the above conditions have been met the employer upon retirement shall enjoy the following tax benefits:

a. A maximum of one third of the commutation upon retirement shall be exempt from tax.
b. The pensioner shall enjoy tax rates applicable to pension income on the monthly receipts.

Tax Calculation on Pensions and Terminal Benefits

3. The Taxation of Terminal Benefits on Pension Withdrawal

According to the 4th Schedule of the Taxation Act, terminal benefits are given to persons on cessation of employment or his withdrawal from or the winding up of the pension fund of which he was a member.

Tax Exemption

The following terminal benefits are exempted from tax:

I. a payment on account of ill health or disability which is paid or would be payable to the beneficiary by reason of the cessation of his employment or his withdrawal from or the winding up of a pension fund.
II. employee contributions which were taxed at the time of making those contributions.
III. K5,000 if the terminal benefits exceed that amount.

Taxable Terminal Benefits

The taxable terminal benefit (after deducting the K5,000) shall comprise:

I. Employer contributions
II. Bonus
III. Interest etc.

Taxing Terminal Benefits

The taxable income is multiplied by the appropriate tax rate to calculate the tax.

Appropriate Rate of Tax

The appropriate rate of tax is calculated by dividing the total tax payable on taxable income by the taxable income.

Appropriate rate of tax = Total tax payable/Taxable Income

For example: If the taxable benefit (after deducting the