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LEGAL UPDATE FAW 17/2009: TAXATION LAWS AMENDMENT ACT NO. 17 OF 2009 – IMPACT ON BENEFITSATWORK

The long awaited Taxation Laws Amendment Act No. 17 of 2009 was promulgated in Government Gazette No. 32610 on 30 September 2009. The following amendments are of relevance to BenefitsAtWork.

1. TAXATION OF WITHDRAWAL BENEFITS

In 2008 it was announced that withdrawal benefits would be taxed in a much simpler way, based on a table similar to that applying in respect of retirement benefits, with the exception that only 7,5% of the R300 000 retirement exemption, that is to say R22 500, would be applicable for pre-retirement withdrawals.

The Revenue Laws Amendment Act No. 60 of 2008 substituted the previous longstanding R1 800 exemption on withdrawal benefits with R22 500 with effect from 1 March 2009, but did not introduce the table.

The Taxation Laws Amendment Act No. 17 of 2009 removed the R22 500 exemption and made it part of the following table, applicable from 1 March 2009:

Taxable income from lump sum benefits	Rate of tax
Not exceeding R22 500	0% of taxable income
Exceeding R22 500 but not exceeding R600 000	18% of taxable income exceeding R22 500
Exceeding R600 000 but not exceeding R900 000	R103 950 plus 27% of taxable income exceeding R600 000
Exceeding R900 000	R184 950 plus 36% of taxable income exceeding R900 000

Withdrawal benefits will be taxed on an accumulated basis. This means that all withdrawal benefits received on or after 1 March 2009 and retirement benefits received on or after 1 October 2007 have to be taken into account in determining the tax payable on a specific withdrawal benefit.

The following example is used in the Explanatory Memorandum on the Taxation Laws Amendment Bill, 2009 (submitted to the Standing Committee on Finance on 10 September 2009) (referred to as "the Explanatory Memorandum"):

Facts: Nthoki is a member of two pension funds when she resigns. Nthoki initially receives a R250 000 pre-retirement lump sum from the first fund. Nthoki subsequently receives another R350 000 pre-retirement lump sum from the second fund.

Result: In respect of the first fund lump sum, the first R22 500 is taxed at rate of zero per cent, and the remaining R227 500 is taxable at rate of 18 per cent. The result is tax payable of R40 950. In respect of the second R350 000 lump sum, this amount is effectively taxed at a rate of 18 per cent, resulting in tax payable of R63 000.

The normal tax concessions continue to apply. For instance, a member will still be able to claim a deduction in respect of their contributions that did not previously qualify for a tax deduction. Deductions are more fully dealt with in a separate document (refer to LEGAL UPDATE FAW 18/2009).

2. TAXATION OF RETIREMENT BENEFITS

The Taxation Laws Amendment Act No. 8 of 2007 introduced the simplification of the calculation of tax on retirement benefits. The exemption amount was increased from R120 000 to R300 000 and the balance of the benefit was taxed in accordance with a special rates table as opposed to the previous complex formula. This applied in respect of the taxation of lump sum retirement and death benefits accruing after 1 October 2007.

The Taxation Laws Amendment Act No. 17 of 2009 amended the Income Tax Act by deleting the definition of "formula B" in the second Schedule. This effectively removed the R300 000 exemption and made it part of the following table, applicable from 1 March 2009:

Taxable income from lump sum benefits	Rate of tax
Not exceeding R300 000	0% of taxable income
Exceeding R300 000 but not exceeding R600 000	R0 plus 18% of taxable income exceeding R300 000
Exceeding R600 000 but not exceeding R900 000	R54 000 plus 27% of taxable income exceeding R600 000
Exceeding R900 000	R135 000 plus 36% of taxable income exceeding R900 000

Retirement benefits will be taxed on an accumulated basis, which means that all withdrawal benefits received on or after 1 March 2009 and retirement benefits received on or after 1 October 2007 have to be taken into account in determining the tax payable on a specific retirement benefit.

The following example is used in the Explanatory Memorandum:

Facts: Nthoki is a member of two pension funds when she resigns. Nthoki initially receives a R250 000 pre-retirement lump sum from the first fund. Nthoki subsequently receives another R350 000 pre-retirement lump sum from the second fund. Nthoki receives an additional R100 000 lump sum on retirement.

Result: The R100 000 is effectively taxed at a rate of 27 per cent after taking into account the prior pre-retirement lump sums, resulting in tax payable of R27 000.

The normal tax concessions previously listed under "E" in "formula B" continue to apply, but are now listed in paragraph 5. For instance, a member will still be able to claim a deduction in respect of their contributions that did not previously qualify for a tax deduction. Deductions are more fully dealt with in a separate document (refer to LEGAL UPDATE FAW 18/2009).

3. TAXATION OF WITHDRAWAL BENEFITS ON RETRENCHMENT

Paragraph (1)(a) of paragraph 2 of the Second Schedule to the Income Tax Act (which deals with the taxation of retirement and death benefits) has been amended to include the following under subparagraph (ii):

“(ii) the termination of his or her employment due to –

(AA) his or her employer having ceased to carry on or intending to cease carrying on the trade in respect of which he or she was employed; or

(BB) that person having become redundant in consequence of his or her employer having effected a general reduction in personnel or a reduction in personnel of a particular class:

Provided that this subitem does not apply to any amount received by or accrued to a person by way of a lump sum benefit where that person’s employer is a company and that person was at any time a director of that company or at any time held more than five per cent of the issued share capital or members’ interest in that company,”.

This is deemed to have come into operation from 1 March 2009 and applies in respect of receipts and accruals on or after that date. Where members’ employment were terminated due to retrenchment after 1 March 2009 but before this amendment became effective, the tax directives issued will be incorrect, as these benefits were taxed as withdrawal benefits.

The implication of this is that withdrawal benefits paid as a result of a member’s retrenchment are to be taxed on the same basis as a retirement benefit, except where the member was a director of the employer-company or had more than a 5% shareholding.

4. BENEFICIARY FUNDS

Beneficiary funds, introduced by the Financial Services Laws General Amendment Act No. 22 of 2008, are funds established exclusively to receive, administer, invest and pay death benefits referred to in section 37C of the Pension Funds Act. As pointed out in the Explanatory Memorandum, *it is envisioned that minor beneficiary funds are relied upon only as a last resort (ie where no other suitable guardian, trust or other mechanism exists).*

The Revenue Laws Amendment Act No. 60 of 2008 amended the Income Tax Act to provide for the following with effect from 1 March 2009:

- the transfer into the beneficiary fund was not to be taxed;
- the growth in that fund would be tax-free, and
- the income from the beneficiary fund would be taxed in the hands of the beneficiary, which would trigger the withholding of PAYE.

In the Explanatory Memorandum the following practical difficulties with this position were pointed out:

Most minor fund beneficiaries are of lesser means and typically expected to receive total income below the annual taxable threshold, even after minor beneficiary fund payouts are fully taken into account. Preliminary estimates indicate that 80 to 90 per cent of these beneficiaries would fall below the threshold. Hence, the compliance and enforcement costs associated with PAYE do not economically justify the ultimate taxes due. The computer system required to run nil returns are especially problematic due to the low annual returns associated with minor beneficiary funds (most funds generating a yield pegged to interest rates).

The Taxation Laws Amendment Act No. 17 of 2009 amends the Income Tax Act as follows with regards to beneficiary funds:

1. Deletes paragraph (eC) of the definition of “gross income” in section 1 – amounts awarded to a person from a beneficiary fund form part of their gross income [deemed

to have come into operation as from the commencement of years of assessment ending on or after 1 January 2009];

2. Inserts section 10(1)(gE) – any amount awarded to a person by a beneficiary fund shall be exempt from normal tax [deemed to have come into effect on 1 March 2009 and applies in respect of amounts awarded on or after that date], and
3. Deletes paragraph (iv) of the proviso to paragraph 3 of the Second Schedule – where a lump sum death benefit is transferred to a beneficiary fund no lump sum benefit shall be deemed to have accrued [deemed to have come into effect on 1 March 2009 and applies in respect of lump sum benefits that –
 - (a) accrue on or after that date; and
 - (b) are not paid to a beneficiary fund on or after 1 March 2009 and before 1 September 2009].

The effects of these amendments are that –

- A transfer to a beneficiary fund will now be taxed as part of the lump sum death benefit;
- The income from the beneficiary fund will no longer be subject to tax, and
- Beneficiary funds that have already received non-taxed transfers in the period between 1 March 2009 and 1 September 2009 will receive exemption on entry and payout (thus the transfer was not taxed and the benefits paid to the beneficiaries will also not be taxed).

5. PRESERVATION FUNDS

Paragraph (b)(ii) of the definition of “pension preservation fund” – this paragraph previously provided for the transfer of a divorce order amount from a pension fund, pension preservation fund, provident preservation fund or retirement annuity fund of which the non-member spouse was a member. This has been corrected and it now only allows for a transfer from a pension fund or pension preservation fund.

Paragraph (c) of the definition of “pension preservation fund” – previously, only a transfer to another pension preservation fund was taken as the exception to the one withdrawal rule. This has been amended to include a transfer to another pension fund as well.

Paragraph (b)(ii) of the definition of “provident preservation fund” – this paragraph previously provided for the transfer of a divorce order amount from a pension fund, pension preservation fund, provident fund, provident preservation fund or retirement annuity fund of which the non-member spouse was a member. This has been corrected and it now only allows for a transfer from a provident fund or provident preservation fund.

Paragraph (c) of the definition of “provident preservation fund” – previously, only a transfer to another provident preservation fund was taken as the exception to the one withdrawal rule. This has been amended to include a transfer to another provident fund as well.

6. MAINTENANCE

Previously, recurrent maintenance payments were taxable in terms of section 7(11) while lump sum maintenance payments were taxable in terms of the Second Schedule to the Income Tax Act.

Section 7(11) was amended to now provide that any maintenance order deductions (including lump sums) and the tax thereon shall be deemed to be income accrued to the member on the date of the deduction.

7. CONTRIBUTIONS TO RETIREMENT ANNUITY FUNDS

Section 11(n) of the Income Tax Act and paragraph 2(4)(bA) of the Fourth Schedule to the Income Tax Act were amended to provide a deduction for a retirement annuity fund contribution in the hands of the employee-member even if the contribution is paid by a third party on their behalf.

8. DEFINITION OF "LUMP SUM BENEFIT"

In previous legislative changes, definitions have been inserted for "retirement fund lump sum benefit" and "retirement fund lump sum withdrawal benefit". This definition is the collective term for these two benefits.

Hettie Joubert
Legal adviser at BenefitsAtWork
Momentum

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