



momentum

# be informed

Legal update 1/2012

30 January 2012

## Taxation Laws Amendment Act, 2011

The Taxation Laws Amendment Act 2011 was promulgated on 10 January 2012. In summary the most important changes to the Income Tax Act 1962 (“ITA”) that are of relevance to Momentum Employee Benefits are the following:

- Taxation of unapproved insurance benefits – refer to Legal Update 2/2012.
- Living annuity – an amount paid to a beneficiary can be paid in 3 ways: 1) as an annuity; 2) as a lump sum, or 3) as a combination of an annuity and a lump sum.
- Umbrella funds – a technical error in the ITA has now been corrected to specifically provide that if an employee who starts employment with an employer after the date on which that employer started participating in an umbrella fund, and meets the eligibility criteria for membership, that employee is compelled to become a member of that umbrella fund.
- Preservation funds – retrenchment benefits can now also be transferred to preservation funds. A member of a provident fund or a provident preservation fund is no longer restricted to only transfer to a provident preservation fund – they can now also transfer to a pension preservation fund.
- Retirement annuity fund – a member can now also transfer his / her benefit from a preservation fund to a retirement annuity fund.
- Severance benefits – are taxed as a retirement lump sum benefits under the retirement tax table.

These changes are discussed below.

### 1. Paragraph (d) and (m) of the definition of gross income read together with the changes in S10(1)(gG) and (gH) – Effective 01 March 2012

Please refer to Legal Update 2/2012 for a detailed explanation of the changes relating to unapproved employer owned policies provided by Momentum Employee Benefits.

### 2. Paragraph (e) in the definition of “living annuity” – Effective 01 March 2012

Makes provision for an amount to be paid to a beneficiary as a combination of an annuity and a lump sum, and not just either an annuity or a lump sum.

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### **3. Subparagraph (bb) in the definition of “pension fund” – Effective 01 January 2012**

Provides that the rules of the fund must specify that membership of the fund will be a condition of employment where an employee joins the employer on or after the date on which the employer becomes a participating employer in an umbrella fund.

### **4. Definition of “pension preservation fund”**

#### **Effective 01 March 2009**

- Aligns the concept of an “unclaimed benefit” in the ITA with the definition found in the Pension Funds Act (“PFA”).
- To allow for the transfer of a retrenchment lump sum to a pension preservation fund.

#### **Effective 01 March 2012**

- Corrects the reference to the Pension Funds Act by deleting the “s” after Pension
- Allows for transfers from a provident fund or provident preservation fund to a pension preservation fund.

### **5. Definition of “provident preservation fund”- Effective 01 March 2009**

- Aligns the concept of an “unclaimed benefit” in the ITA with the definition found in the PFA.
- To allow for the transfer of a retrenchment lump sum to a provident preservation fund.

### **6. Definition of “retirement annuity fund”- Effective 01 March 2012**

To allow for transfers from a pension preservation fund and a provident preservation fund to a retirement annuity fund.

### **7. Definition of “retirement date”- Effective 01 March 2009**

To refer specifically to paragraph 2(1)(a)(i) of the Second Schedule that deals only with lump sum retirement or death benefits. The previous reference to paragraph 2(1)(a) included retrenchment. This just clarifies that the definition of “retirement date” does not apply in the case of retrenchment.

### **8. Definition of “severance benefit”**

#### **Effective 01 March 2012**

- To prevent a severance benefit from being included and taxed as normal income as severance benefits are now taxed as retirement lump sum benefits under the retirement tax tables.

#### **Effective 01 April 2012**

- Includes a new definition of the word “share”, which clarifies that the term share includes similar equity interests.
- The words “share capital” have been replaced by the word “shares”.

### **9. Section 6: Normal tax rebates – Effective 01 March 2011**

Adds a “severance benefit” to the amounts that will be excluded from being taxed according to the normal tax rates as a severance benefit is now taxed as a retirement lump sum benefit.

### **10. Section 9: Source of Income – Effective 01 January 2012**

South African residents are taxed on their world-wide income with foreign sourced income eligible for tax rebates while non-residents are only taxed on income derived from sources within SA or deemed to be within SA.

The source for annuities and pension payments will be based on the source of the underlying services giving rise to these payments.

So if the service related to these annuities and pension payments is rendered within SA, the annuities and pensions will be seen as SA sourced income and will accordingly be taxed in SA. If services are rendered in SA and out of SA, then the allocation will be based on the actual time spent in SA and the other country.

#### **11. Section 11(n)(i)(aa): Deductions – Effective 01 March 2011**

Includes a “severance benefit” to the amounts that the taxpayer may not take into account when calculating the permissible deduction for retirement annuity contributions.

#### **12. Section 11(w)(i): Deductions – Effective 01 March 2012**

For employer owned insurance policies, the employer will be allowed a deduction in terms of section 11(w)(i) if the amount of the premium paid by the employer for the benefit of the employee or his dependants is included as a fringe benefit for the employee.

For income protection policies, there will be a corresponding deduction for the employee in terms of section 11(a) in respect of the fringe benefit included in the employee’s income. The inclusion of a fringe benefit and the deduction of the premium for the employee will result in a monthly set off and will leave the employee in a tax neutral position. This will however result in the income protection benefit being taxed in the hands of the employee.

Please also see Legal Update 2/2012.

#### **13. Section 11 (w)(ii): Deductions – Effective 01 March 2012**

Key person policies are *not* provided by Momentum Employee Benefits, but the changes will be discussed. This section deals with the impact of a conforming or non-conforming policy on key person plans.

The deductibility of the premiums by the taxpayer / employer depends on whether the policy is conforming (has to comply with certain statutory requirements) or non-conforming. For a conforming policy, the premiums are deductible upfront and the proceeds are taxable, while the premiums for a non-conforming policy are not deductible and the proceeds are normally viewed as tax-free.

*From 01 March 2012*, the employer will have to *opt* for a conforming policy if they wish to have the upfront deduction of the premiums. This must be done by expressly stating in the policy that section 11(w)(ii) must apply to the policy agreement. If the employer does not exercise an option, the policy will automatically be a non-conforming one. The once off choice cannot be changed at a later stage.

For all key person policies *existing prior to 01 March 2012*, the employer must add an addendum to the policy which states that section 11(w)(ii) must apply. Again this is a once off choice and must be expressed by 31 August 2012. If no addendum is added to the policy agreement, the policy will be viewed as a non-conforming one and therefore not taxable upon pay-out.

The following requirements must be met for the contributions to a key person policy to be tax deductible:

- The taxpayer must “opt in” for section 11(w)(ii) to apply;
- The taxpayer is insured against any loss due to the death, disablement or severe illness of the employee;
- The policy is a risk policy with no cash value, and
- The policy is not the property of any other person than the taxpayer at the time of paying the premium.

**14. Paragraph (d)(iii) in the definition of gross income and Section 23(p) – Effective 01 March 2012**

**Cession of deferred compensation**

All premiums paid by the employer must be included in the employee's income as a taxable fringe benefit. Thereafter any cession or payout *will not* be taxable as long as *all* the premiums paid by the employer were taxed as a fringe benefit in the employee's hands.

**Cession of pure risk policies**

This cession should not be seen as taxable income in the hands of the employee.

**15. Paragraph 2C of the second schedule – Effective 01 March 2012**

Corrects the reference to the Pension Funds Act by deleting the "s" after Pension.

**16. Paragraph 4 of the Second Schedule – Effective 01 March 2012**

The general timing rules are made subject to paragraphs 3 and 3A of the Second Schedule which deals with the death of a member or past member and the death of any other person respectively.

**17. Paragraph 6 of the Second Schedule – Effective 01 March 2012**

Allow for tax-free transfers from preservation funds to a retirement annuity fund, and from provident funds and provident preservation funds to pension preservation funds. A list of all tax-free transfers are attached as Annexure A.

**18. Paragraph 2 of the Fourth Schedule, Paragraph 2(k) of the Seventh Schedule and paragraph 12C of the Seventh Schedule – Effective 01 March 2012**

Makes provision for the insurance premiums paid by the employer on behalf of the employee to be taxed as a fringe benefit in the hands of the employee. These changes make it compulsory for employers to ensure that the premiums in respect of a disability income benefit are taxed as a fringe benefit, and for a corresponding deduction in the hands of the employee under section 11(a).

**19. Paragraph 55 of the Eighth Schedule – Capital gains tax: Effective 10 January 2012**

Risk policies have been excluded from the application of capital gains tax including second hand risk policies.

There is also specific exemption from capital gains tax in respect of employer owned long-term insurance policies if the amount to be taxed is included in the gross income of any person. That amount will be exempted from capital gains tax even if it is subsequently exempted from gross income in terms of section 10(1)(gG) or section 10(1)(gH).

**20. Appendix 1 – Rates of normal tax and rebates**

In determining the tax payable by a member upon withdrawal or retirement from a fund, the following benefit payments must be taken into account:

- (i) Any lump sum withdrawal benefits received or accrued on or after 01 March 2009;
- (ii) Any retirement fund lump sums received or accrued on or after 01 October 2007; and
- (iii) Any severance benefits received or accrued on or after 01 March 2011.

**ANNEXURE A – TAX-FREE TRANSFERS FROM 1 MARCH 2012**

FROM	TO
Pension	Pension
	Pension preservation
	RA
Pension Preservation	Pension
	Pension preservation
	RA
Provident	Pension
	Pension preservation
	Provident
	Provident preservation
	RA
Provident Preservation	Pension preservation
	Provident
	Provident preservation
RA	RA