

Legal update

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Preservation Funds

Background

In 2008 new definitions for *pension preservation funds* and *provident preservation funds* were introduced into the Income Tax Act (“ITA”). Further changes to the definition of *pension preservation fund* were made in Retirement Fund Note RF 1 / 2011 which replaced RF 1 / 98 and its addenda with effect from 30 September 2010. RF 1 / 2011 has subsequently been replaced by RF 1 / 2012 which came into effect on 1 November 2012. This Legal Update provides a quick guide, followed by a detailed discussion on how a preservation fund operates.

Quick guide to preservation funds

Employer participation	This is no longer a requirement. An employee can transfer his benefit to a preservation fund of his choice.
Benefits that can be transferred to a preservation fund	Resignation, retrenchment, dismissal, winding up, section 197 transfer, unclaimed benefits and divorce benefits.
Transfers between preservation funds	A member may transfer his benefit from one preservation fund to another. Section 14(1) of the Pension Funds Act (“PFA”) will not apply and the transfer will be tax-neutral.
Transfer from an occupational fund to a preservation fund	A member may transfer his benefit from a <u>provident fund</u> to a provident preservation fund <i>or</i> a pension preservation fund. A benefit from a <u>pension fund</u> may only be transferred to a pension preservation fund. These transfers are tax-neutral.
Translocation of benefits	A member may take a portion of his benefit from the occupational fund in cash and transfer the balance to a preservation fund. A section 37D deduction from a pension/provident fund benefit will not affect a member’s right to take a portion of his benefit in cash and transfer the balance to a preservation fund.
Once-off withdrawal	A member will have a <i>further</i> once-off withdrawal from a preservation fund.
Benefits paid or transferred into	A benefit <i>from</i> a pension fund or pension preservation

a pension preservation fund	fund may not be split between more than one pension preservation fund.
Benefits paid or transferred from a pension preservation fund	<p>A benefit <i>from</i> a pension preservation fund may only be paid or transferred to:</p> <ul style="list-style-type: none"> • one pension fund, • one pension preservation fund, • one retirement annuity fund; • a combination of one pension preservation and one retirement annuity fund; • a combination of one pension fund and one pension preservation fund; or • a combination of one pension fund and one retirement annuity fund. <p>A portion of the benefit can be retained in the pension preservation fund.</p>
Benefits paid or transferred from a provident fund or provident preservation fund	<p>A member may split his benefit from a provident fund or a provident preservation fund to any number of combinations of permitted funds.</p>
Transfer from a preservation fund to a retirement annuity fund	<p>This transfer will be tax-neutral, but is currently regarded as the member's once-off withdrawal from the preservation fund. The Taxation Laws Amendment Bill of 2012 once promulgated will correct this position and such transfers will <i>not</i> be regarded as the member's once-off withdrawal from the preservation fund.</p>
Retirement from a preservation fund	<p>A member</p> <ul style="list-style-type: none"> • may retire at any time <i>after</i> reaching the age of 55 if provided for in the fund's rules; • is no longer required to retire from the preservation fund if he retires from employment; and • may retire from the preservation fund even if he is still in employment.

Detailed discussion on preservation funds

The participation of the employer is no longer required

The new definitions of *pension preservation fund* and *provident preservation fund* releases a preservation fund from the employer-employee relationship which is a requirement for approval of a normal pension and provident fund. An employee may now choose his own preservation fund when he / she leaves employment and the former employer's participation in the preservation fund is no longer required.

Who can become a member of a preservation fund?

The following can become members of a preservation fund:

- (i) Former members of a pension or provident fund whose membership of that fund terminated due to resignation, retrenchment, dismissal from employment or the winding up of the pension or provident fund, which includes a partial winding up (see Legal Update 15 / 2010 for more information) and who elected to have their benefit transferred to the preservation fund. This includes a transfer of business as a going concern under the Labour Relations Act (section 197 transfers).
- (ii) Former members of a preservation fund that was wound up or where a member himself elected to transfer to any other preservation fund.
- (iii) Former members of the previous fund or their nominees or dependants of that fund in respect of an unclaimed benefit.
- (iv) Divorcees who elect to transfer their divorce benefit to that fund.

Transfers between preservation funds

A member may transfer between preservation funds ie pension preservation fund to pension preservation fund and provident preservation fund to provident preservation fund *or* pension preservation fund. These transfers will be tax-neutral.

The Financial Services Board (FSB) has confirmed in Directive PF no. 6 dated 15 December 2011 that section 14(1) of the PFA will not apply to transfers between preservation funds.

Benefits paid or transferred to a preservation fund

SARS has confirmed in the revised RF 1 / 2012 issued on 1 November 2012 that a member may take a portion of his withdrawal benefit from the occupational fund in cash and transfer the *balance* to a preservation fund. The member is then also entitled to *another* withdrawal from the preservation fund itself.

Any amount deducted from the benefit in terms of section 37D of the Pension Funds Act (see Legal Update 14/2011) will not affect a member's right to take a portion of his benefit in cash and transfer the balance to a preservation fund. For example if a member has a housing loan that needs to be settled from his withdrawal benefit, the member can still take a portion of his benefit in cash and transfer the balance to a preservation fund, even though a deduction has been made to settle the housing loan.

Benefits from a *pension fund* or *pension preservation fund* may not be transferred or paid in such a way that the benefit is split between more than one pension preservation fund. In other words, a member cannot transfer a part of a withdrawal benefit to pension preservation fund A and the rest to pension preservation fund B.

Benefits paid or transferred *from* a preservation fund

Benefits from a *pension preservation fund* may only be paid or transferred to:

- one pension fund;
- one pension preservation fund;
- one retirement annuity fund;
- a combination of one pension preservation and one retirement annuity fund;
- a combination of one pension fund and one pension preservation fund; or
- a combination of one pension fund and one retirement annuity fund.

The member can also leave a portion of his benefit in the pension preservation fund and then transfer the balance to a pension fund or retirement annuity fund.

The intention is to *prevent splitting between funds* in a way that allows a member to potentially have less than R75 000 in each fund resulting in the member upon retirement being able to take the full benefit in cash from each fund rather than purchasing an annuity with at least two-thirds of the benefits as required by law.

The condition does not affect benefits from a provident fund or a provident preservation fund because access to the full benefit in a provident fund is already possible. A member may therefore split his benefit from a provident fund or a provident preservation fund to any number of combinations of permitted funds. For example, a member's benefit from a provident preservation fund can be split between five funds, a pension fund, provident fund, provident preservation fund, pension preservation fund and retirement annuity fund.

Further, this condition applies separately in respect of each payment or transfer made into a pension preservation fund. If a member transferred two different withdrawal benefits into the *same* pension preservation fund, it means that the member has two translocation benefits in the pension preservation fund. The member will then be able to, for example take a portion of one of these translocation benefits in cash, with the rest of that benefit remaining in the fund until retirement. He can then also transfer a part of the second translocation benefit to another pension fund, pension preservation fund or retirement annuity fund, with the rest of that translocation benefit also remaining in the fund.

Transfers from a preservation fund to a retirement annuity fund

With effect from 1 March 2012,

- the definition of "retirement annuity fund" in the ITA has been amended to allow for transfers from a preservation fund to a retirement annuity fund; and
- Paragraph 6 of the Second Schedule has been amended to allow for the tax free transfer of a benefit from a preservation fund to a retirement annuity fund.

RF 1 / 2012 confirms that a member may transfer his benefit from a preservation fund to a retirement annuity fund and such transfer will be allowed as a deduction in terms of paragraph 6 of the Second Schedule, so the transfer will be a tax neutral event.

Matter that still requires clarification or legislative amendment

The current definitions of “*pension preservation fund*” and “*provident preservation fund*” provide that the transfer of a benefit from a preservation fund to a retirement annuity fund will be regarded as the member’s once-off withdrawal. The proposed amendments to preservation fund definitions (in the Taxation Laws Amendment Bill of 2012 (“the Bill”)) means that the member can transfer his benefit to a retirement annuity fund and it will *not* be regarded as the member’s once-off withdrawal.

If an amount is transferred before the promulgation of the Bill, such transfer may be regarded as the member’s once-off withdrawal as it is uncertain whether this legislation will be promulgated with retrospective effect.

Taxation of a withdrawal benefit

The transfer of the withdrawal benefit from an occupational fund to a preservation fund did not, in terms of paragraph 6 of the Second Schedule to the ITA, attract income tax. This still applies whether it is from a former employer’s fund, a former preservation fund to which a member belonged or as a result of a divorce order amount being transferred to the preservation fund.

Any withdrawal from the preservation fund *prior to retirement* will be taxed in accordance with the withdrawal tax tables.

Early retirement and normal retirement benefits

A member will become entitled to a retirement benefit at any time from reaching the age of 55 years, depending on the rules of the preservation fund. There is no longer a requirement that a member who retires from employment must retire from the preservation fund and a member may retire from the preservation fund even if he is still in employment.

A member who becomes permanently incapable of carrying on his occupation due to sickness, accident, injury or incapacity through infirmity of body or mind (medically disabled) can also retire.

Unclaimed benefits

Preservation funds can also be established to *specifically* house ‘unclaimed benefits’ (eg where no benefit has been paid to a member or his dependants within 24 months of the benefit becoming due). Unclaimed benefits are normally transferred into preservation funds that have been set up specifically for that purpose (unclaimed benefits preservation funds) and not into other preservation funds.

Rule amendments

The trustees of preservation funds must ensure that their rules comply with the requirements of the revised RF 1 / 2012. Rules that require amendment must be submitted for approval on or before 28 February 2013.

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