Legal update

No. 2 of 2016 • January 2016

Taxation Laws Amendment Act No 25 of 2015

This Legal Update must be read together with Legal Updates 3 and Legal Update 4 of 2016.

A. The Amendment Act

The Taxation Laws Amendment Act No. 25 of 2015 that was published in Government Gazette No. 39588 on 8 January 2016 changes the following for employee benefits:

1. confirms the changes to the tax treatment of retirement fund contributions (refer to Legal Update 3 of 2016);
2. aligns the annuitisation requirements between retirement funds (refer to Legal Update 4 of 2016);
3. includes public sector funds under the annuitisation alignment;
4. closes the loophole to avoid estate duty through excessive contributions to retirement annuity funds; and
5. allows non-residents to withdraw from a retirement annuity fund when they leave South Africa.

This Legal Update summarises the first two changes and explains the last three.

B. Tax treatment of retirement fund contributions

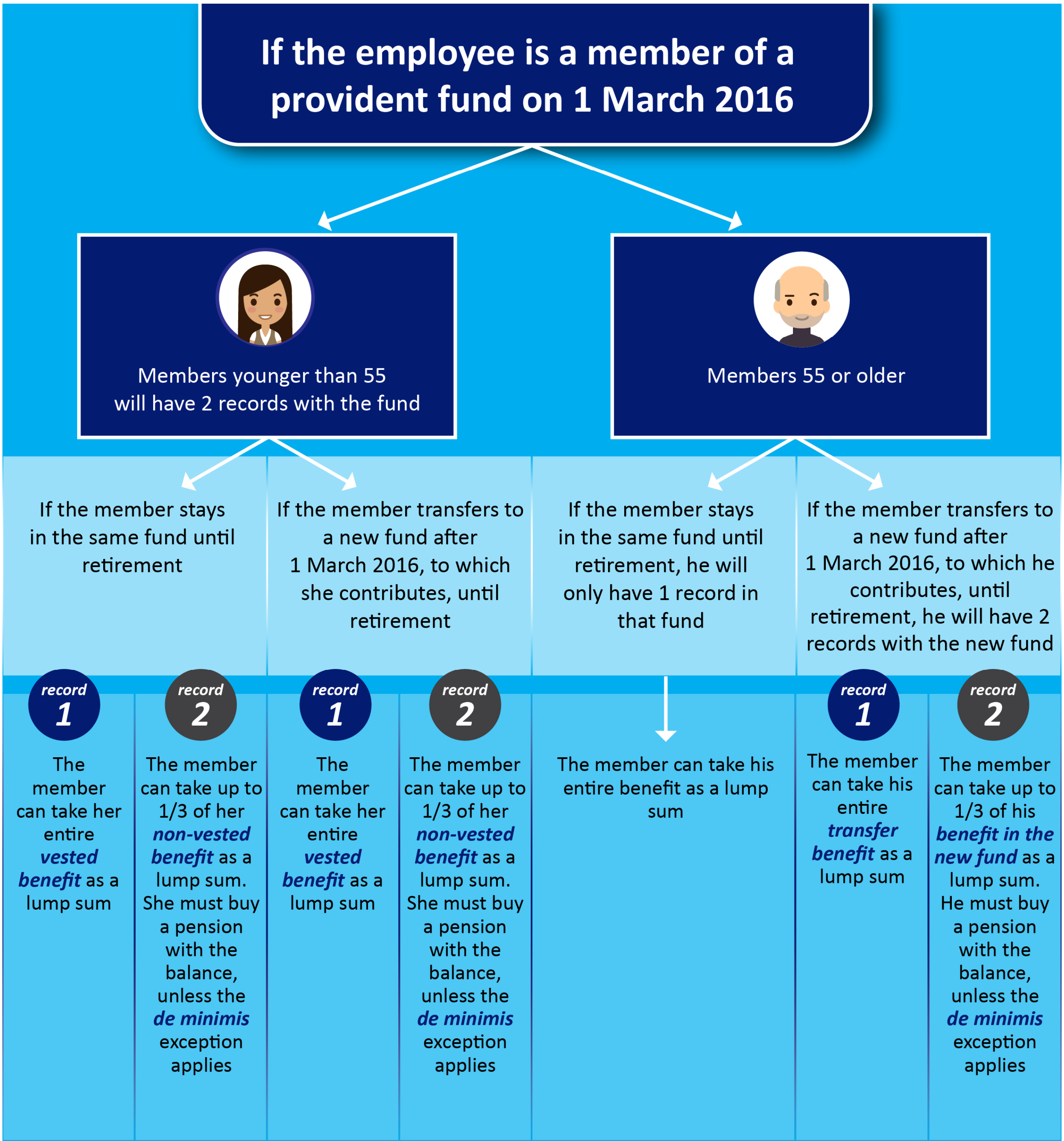
Effective from 1 March 2016

	Tax effect on member	**Tax effect on employer**
Employer contribution	Taxed as fringe benefit in member's hands	Gets deduction
Deductions allowed	Member and employer contribution, including approved insurance benefit premiums and administration costs. Administration costs include commission & investment advice fees	Employer contribution
Deduction limit	27,5% of the higher of the member's remuneration and taxable income, subject to a maximum of R350 000 per year	Unlimited
Unapproved insurance benefit premiums	Deduction not allowed. Member pays fringe benefit tax on these premiums	Deduction still allowed

C. Alignment of annuitisation requirements between retirement funds

Effective from 1 March 2016

1. Fund alignment – <u>retirement</u>



Definitions

Vested benefit	The member's benefit in the provident fund on 29 February 2016, plus growth thereon
Non-vested benefit	All contributions and other amounts credited from 1 March 2016, plus growth thereon
De minimis exception	If the benefit is less than R247 500, the member can take everything in a lump sum
Transfer benefit	The member's benefit in the provident fund of which he was a member on 1 March 2016, that is transferred to his new fund
Benefit in the new fund	The member's benefit built up with contributions and other amounts credited to the new fund from the date that he started contributing to the new fund, plus growth thereon

2. Permitted transfers between retirement funds

From	To
Any: **Pension fund** **Pension preservation fund** **Provident fund** **Provident preservation fund**	**Any:** **Pension fund** **Pension preservation fund** **Provident fund** **Provident preservation fund** **Retirement annuity fund**
Retirement annuity fund	**Retirement annuity fund**

D. Public sector pension funds

- Paragraph (a) of the definition of "pension fund" in the Income Tax Act refers to funds established by law, for example the Telkom Pension Fund, and municipal funds.
- Paragraph (b) of that same definition refers to any pension fund established for employees of a control board as defined in the Marketing of Agricultural Products Act or for employees of the Development Bank of Southern Africa, where the rules of those funds are similar to the rules of the Government Employees Pension Fund (GEPF).
- Paragraph (a) and (b) pension funds are known as public sector funds. Before 1 March 2016, the general rules applying to pension funds did not apply to these funds. For all intents and purposes, they functioned like provident funds. In the Second Schedule to the Income Tax Act, a public sector fund whose rules allowed for more than one-third of the retirement benefit to be taken as a lump sum at retirement were in fact defined as a provident fund. A member of a municipal fund for example, was not limited to taking only one-third of his retirement benefit as a lump sum and buying an annuity with the rest. If the fund's rules allowed for it, he could take his whole retirement benefit in a lump sum.
- When the alignment of post-retirement benefits across pension, provident and retirement annuity funds was first introduced in the Taxation Laws Amendment Act No. 31 of 2013, public sector funds were not included under the annuitisation alignment. The Taxation Laws Amendment Act No. 25 of 2015 now does include them.
- From 1 March 2016, public sector funds will have the same rules applying to them as provident funds. They will also be required to impose the annuitisation rules. This means that the members of these funds will then be restricted to only taking a maximum of one third of the retirement benefit in a lump sum and buying an annuity with the rest.
- The GEPF will not be subject to the annuitisation rule. Their rules already provide that if the member has 10 or more years of service at retirement, he can only take one-third of his retirement benefit in a lump sum, using the rest to buy an annuity.

E. Closing the loophole to avoid estate duty through excessive contributions to retirement annuity funds

This amendment becomes effective from 1 January 2016 and applies to the estate of a member who dies on or after that date, for contributions made on or after 1 March 2015.

<u>Position before 1 January 2009:</u>

- A member in a retirement annuity fund had to retire and buy an annuity before reaching 70.

Position after 1 January 2009:

- The Taxation Laws Amendment Act, No 3 of 2008, amended the Income Tax Act by removing the restriction of 70 years for a retirement annuity fund member in the definition of "normal retirement age". This allows an individual to become a member of and contribute to a retirement annuity fund after age 70.
- The Revenue Laws Amendment Act, No. 60 of 2008, amended the Estate Duty Act to exclude death benefits from retirement funds from the property that constitutes a deceased member's estate. This effectively excluded retirement fund death benefits from estate duty.

Opportunity created by 1 January 2009 changes:

- Retirement annuity funds could be used to avoid estate duty. Any contributions that did not previously qualify for a tax deduction would qualify as a tax deduction under paragraph 5 of the Second Schedule to the Income Tax Act when the benefit became payable upon the member's death. The balance of the benefit would then be subject to the retirement tax table. The death benefit would also not be subject to estate duty.
- A member on his death bed could for example contribute a large capital amount to a retirement annuity fund. If he then passes away shortly afterwards, this total capital amount can be deducted from his retirement annuity fund benefit. If the balance to be taxed is less than R500 000, which would mean that the total benefit from the retirement annuity fund would be tax free. The capital, which would otherwise have been subject to estate duty if it fell into his deceased estate, would then effectively become tax free.
- The same opportunity potentially also presented itself for pension and provident funds.

Closing the loophole:

- Section 3 of the Estate Duty Act has been amended to provide that so much of the contributions made to a retirement fund that did not qualify for a tax deduction, will be included in the property that constitutes a deceased member's estate.
- If a member now made contributions to a retirement annuity fund after 1 March 2015 which did not qualify as a tax deduction, and he dies after 1 January 2016, those contributions would still qualify for a tax deduction under paragraph 5 of the Second Schedule to the Income Tax Act when the member passes away. It would, however, now be included under "property" as stipulated in section 3 of the Estate Duty Act, which means that it will be subject to estate duty.

F. Withdrawal from retirement annuity by non-residents

Effective from 1 March 2016.

Position before 1 March 2016:

- Paragraph (b)(x)(dd) of the definition of "retirement annuity fund" in section 1 of the Income Tax Act allows a member who *emigrates* to be paid a lump sum retirement annuity benefit before his retirement date if that emigration is recognised by the South African Reserve Bank for purposes of exchange control. ***E****migrate* means you are ***e****xiting* your current homeland.
- It does not have a similar allowance for a member who immigrates before their retirement date. ***I****mmigrate* means you are coming ***i****nto* a country to live.

Position after 1 March 2016:

- The definition of "retirement annuity fund" has been amended to allow expatriates to withdraw a lump sum benefit from their retirement annuity fund before their retirement date if –
    - they cease to be a resident as defined in the Income Tax Act; or

    - they leave South Africa when their work or visit visa expires.

- This means that both a member that emigrates and one that immigrates will be entitled to the payment of a lump sum benefit from their retirement annuity fund when they leave South Africa before their retirement date.

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