momentum

Legal updates

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Revenue Laws Amendment Act

This Legal Update must be read together with Legal Update 4 of 2014 and Legal Update 4 of 2016, with the effective date now being 1 March 2018. It must also be read together with Legal Update 3 of 2016, which looks at the impact of the changes to retirement fund contributions on members and employers.

A. The Amendment Act

The Revenue Laws Amendment Act No. 2 of 2016 was published in Government Gazette No. 40006 on 20 May 2016. This Act confirms the postponement of the alignment of the annuitisation requirements between pension, provident and retirement annuity funds. It also provides for the increase in the *de minimus* amount from R75 000 to R247 500 upon retirement of a member of a pension, pension preservation or retirement annuity fund. This Legal Update gives more information on these changes.

B. Summary

	Impact of change
Provident fund and public sector fund retirement benefit	The member can still take his whole retirement benefit in a lump sum
Transfers between funds	Only transfers from a fund with less restrictions to a fund with similar or more restrictions are allowed
***De minimis* rule (only applicable in pension, pension preservation and retirement annuity funds)**	Increased from R75 000 to R247 500 from 1 March 2016

C. Annuitisation alignment between retirement funds

The changes relating to the annuitisation of retirement benefits in provident funds and public sector funds as set out in the Taxation Laws Amendment Act No. 25 of 2015 (TLAA) that were published in Government Gazette No. 39588 on 8 January 2016, have been postponed to 1 March 2018. This means that the position as it applied before the TLAA will apply: members in provident funds, provident preservation funds and *public sector funds will still be able to take their whole retirement benefit in a lump sum, until the annuitisation changes come into effect on 1 March 2018.

*Refer to paragraph D of Legal Update 2 of 2016 for an explanation of what a public sector fund is.

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D. Tax free transfers between retirement funds

Due to the postponement of the annuitisation changes, the transfer rules as they applied before the TLAA will continue to apply. The impact of this is that only transfers from funds with less restrictions to funds with similar or more restrictions will be allowed as tax free transfers. For example, a transfer from a provident fund (where the member is allowed to take his whole retirement benefit in a lump sum: no restriction) to a pension fund (where the member is limited to only 1/3rd of his retirement benefit as a lump sum: more restrictive) will be allowed as a tax free transfer.

The following table sets out the tax free transfers.

From	To
Pension Fund	Pension Fund Pension Preservation Fund Retirement Annuity Fund
Pension Preservation Fund	Pension Fund Pension Preservation Fund Retirement Annuity Fund
Provident Fund	Pension Fund Pension Preservation Fund Provident Fund Provident Preservation Fund Retirement Annuity Fund
Provident Preservation Fund	Pension Preservation Fund Provident Fund Provident Preservation Fund Retirement Annuity Fund
Retirement Annuity Fund	Retirement Annuity Fund

E. *De minimis* rule

1. Pension, pension preservation and retirement annuity funds

The *de minimis* amount for pension funds, pension preservation funds and retirement annuity funds has increased from R75 000 to R247 500 from 1 March 2016. If the member's total retirement interest in any of these funds is less than R247 500 at retirement, the member can take his whole retirement benefit in a lump sum. If it is R247 500 or more, the one-third restriction will apply, which means that the member will have to buy an annuity with the remaining two-thirds.

The *de minimis* rule applies per fund. It is *not* restricted to one application per lifetime or accumulated across different funds. If a member for example has a retirement benefit of R100 000 each in a pension fund, pension preservation fund and retirement annuity fund, he will be entitled to take all three retirement benefits as a lump sum.

2. Provident, provident preservation and public sector funds

Because a member in a provident fund and a provident preservation fund can take their whole retirement benefit in a lump sum, the *de minimis* rule does not apply to them. It also does not apply to public sector funds. The public sector funds referred to in paragraphs (a) and (b) of the definition of "pension fund" in section 1 of the Income Tax Act are not subject to the annuitisation requirement

(where the member must buy a pension with at least two-thirds of his retirement benefit). A member of these funds is allowed to take his whole retirement benefit in a lump sum if their fund rules allow for it. Although the Government Employees Pension Fund, referred to in paragraph (c) of the definition of "pension fund" in section 1 of the Income Tax Act, is also not subject to the annuitisation requirement, the rules of that fund includes a restriction on what could be taken as a lump sum at retirement.

3. Pension preservation fund

A member of a preservation fund is allowed to make one withdrawal from each underlying transfer to the preservation fund. This means that if the member transferred three withdrawal benefits into the same preservation fund, he will be allowed to make one pre-retirement withdrawal from each of those three transferred amounts (in total, three withdrawals before retirement) – which can be up to a full withdrawal of each transferred amount. The *de minimis* rule however will not apply separately to each one of these amounts at retirement from that fund.

The *de minimis* rule applies to "the total value of the retirement interest" of the member. "Retirement interest" is defined as "a member's share of the value of a … pension preservation fund … as determined in terms of the rules of the fund upon his or her retirement date". SARS General Note GN16 confirms that in regard to a defined contribution fund, the member's share of the fund would be the amount in their member account on their "retirement date". It further confirms that in the case of a member of a pension preservation fund in respect of whom multiple policies or contracts are held in the fund, the "retirement interest" of the member is the total value of all the policies or contracts under the fund on any particular "retirement date". Where there is more than one retirement date for each of the policies or contracts, the *de minimis* rule must be applied to the member's total benefit in the pension preservation fund on the different retirement dates. If the member elects to retire from one of the policies or contracts, he will not be able to take that benefit as a lump sum (even if it is below the *de minimum* amount) if the total retirement benefit in the fund, across all policies and contracts, exceeds the *de minimis* amount.

4. Retirement annuity fund

As with a pension preservation fund, the *de minimis* rule applies to "the total value of the retirement interest" of a member in a retirement annuity fund. "Retirement interest" is defined as "a member's share of the value of a … retirement annuity fund as determined in terms of the rules of the fund upon his or her retirement date". "Retirement date" in turn is defined as "the date on which a member of a … retirement annuity fund, in terms of the rules of that fund, becomes entitled to an annuity or a lump sum benefit contemplated in paragraph (2)(a)(i) of the Second Schedule on or subsequent to attaining normal retirement age". SARS General Note GN16 confirms that in regard to a defined contribution fund, the member's share of the fund would be the amount in their member account on their "retirement date". It further confirms that in the case of a member of a retirement annuity fund in respect of whom multiple policies or contracts are held in the fund, the "retirement interest" of the member is the total value of all the policies or contracts under the fund on any particular "retirement date". Where there is more than one retirement date for each of the policies or contracts, the *de minimis* rule must be applied to the member's total benefit in the retirement annuity fund on the different retirement dates. If the member elects to retire from one of the policies or contracts, he will not be able to take that benefit as a lump sum (even if it is below the *de minimum* amount) if the total retirement benefit in the fund, across all policies and contracts, exceeds the *de minimis* amount.

4. Compulsory conventional annuity (Life annuity)

The increase in the *de minimis* amount for retirement funds does not mean that the life annuity *de minimis* amount is automatically increased. The life annuity *de minimis* amount was determined as follows by SARS in General Note GN 16 which was issued on 31 March 2010:

> *… where a retirement fund administrator, or a South African long-term insurer in the case of annuities purchased in the name of the member or former member (GN18-annuities), is satisfied that a member or former member who is in receipt of an annuity did not commute any portion of his or her "retirement interest" the member or former member may, subject to the terms and conditions of the annuity, commute the annuity for a lump sum on condition that the total value of the "retirement interest" did not exceed R75 000 on the "retirement date" of the member.*
>
> *Where a member or former member commuted before, or where the retirement fund administrator is unable to determine whether such a commutation occurred, the annuitant may, subject to the terms of the annuity, commute the remaining annuity for a lump sum if two-thirds of the member's "retirement interest" on the "retirement date" of the member did not exceed R50 000.*

These *de minimus* amounts have not been increased since 2010.

5. Compulsory linked annuity (Living annuity)

As with a life annuity, the increase in the *de minimis* amount for retirement funds does not mean that the living annuity *de minimis* amount is automatically increased. The living annuity *de minimis* amount is prescribed by the Minister of Finance. This flows from paragraph (c) of the definition of "living annuity" in section 1 of the Income Tax Act, which provides as follows:

> *the full remaining value of the assets contemplated in paragraph (a) may be paid as a lump sum when the value of those assets become at any time less than an amount prescribed by the Minister by notice in the Gazette (own emphasis)*

Government Notice 1164 of 30 October 2008 prescribed that the amount referred to in this paragraph must be an amount of

> *(a) R50 000, if any of the value of the annuity or any part of the retirement interest was previously commuted for a single payment; or*
>
> *(b) R75 000, in any other case.*

National Treasury has been requested to consider an increase in these amounts in line with the increase in the *de minimis* amount for pension, pension preservation and retirement annuity funds to R247 500. To date, it has not been increased. The amounts determined in 2008 accordingly still apply for living annuities.

F. Allowable deduction for fringe benefit of employer contributions to defined benefit pension funds

In the Budget Speech earlier this year, the following was pointed out:

> *Section 11(k)(iii) of the Income Tax Act inadvertently limited the allowable deduction for the fringe benefit of employer contributions to retirement funds to the actual value of the employer contribution. However, the fringe benefit value for defined benefit pension funds is determined by a formula provided in paragraph 12D of the Act's Seventh Schedule and may be larger than the actual value of the employer contribution (because the fringe benefit is dependent on the value of benefits and not the funding position of the defined benefit pension fund). In this case, the available deduction would not be aligned with the employer contribution's fringe benefit value and any*

excess amount would become taxable. This was not the original intention and the legislation will be adjusted to allow a deduction up to the full value of the employer contribution fringe benefit, if valued according to paragraph 12D of the Seventh Schedule. The amendment will take effect from 1 March 2016.

This has now been corrected. The amended Section 11(k)(iii) now provides for the deemed employee contribution to be equal to the value of the fringe benefit under paragraph 12D of the Seventh Schedule to the Income Tax Act, even if such value is greater than the actual contribution paid by the employer.

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