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Legal update 3 of 2021: Taxation Laws Amendment Act No. 23 of 2020

Introduction

The Taxation Laws Amendment Act No. 23 of 2020 was promulgated in Government Gazette No. 44083 on 20 January 2021.

The following changes are relevant for the retirement fund industry:

1. Retirement fund reform: Annuitisation of provident funds
2. Deduction of previously disallowed contributions
3. Retail fund withdrawals due to emigration
4. Living annuity: termination of trust
5. Surviving spouse's pension

These amendments are discussed in more detail below.

1. Annuitisation of provident funds

Background: The Taxation Laws Amendment Act No. 25 of 2015 introduced a uniform tax treatment of contributions to retirement funds, the alignment of the annuitisation requirements between retirement funds and the inclusion of public sector funds under the annuitisation alignment. Refer to paragraphs A – D of Legal update 2 of 2016 for more information on these changes, with the substitution of the date of 1 March 2016 with 1 March 2021.

While the first of these changes was implemented from 1 March 2016, the annuitisation alignment was first postponed to 1 March 2018, then to 1 March 2019 and eventually to 1 March 2021, pending consultations with the National Economic Development and Labour Council (Nedlac). The annuitisation of provident funds will now go ahead on 1 March 2021.

Legal update 4 of 2016 explains the impact of the annuitisation on members and employers of provident funds. This is still relevant, with the substitution of the date of 1 March 2016 with 1 March 2021.

The annuitisation of provident funds apply to employees who are members of provident funds on 1 March 2021 and can be summarised as follows:

a. Provident fund member on 1 March 2021, younger than 55:

   Vested benefit =

   i. accumulated benefit up to 1 March 2021
   ii. + amounts credited to i
   iii. + growth on i and ii
   iv. - proportionate section 37D deductions.

Non- vested benefit =

v. contributions after 1 March 2021

vi. + amounts credited to v after 1 March 2021

vii. + growth on v and vi

viii. - proportionate section 37D deductions.

Provident Fund: member < 55 on 1/3/21		
	Pre-1/3/21 vested benefit	Post 1/3/21 non-vested benefit
Resignation	Can take total benefit as lump sum. Taxed on withdrawal tax table.	
Retirement	Can take vested benefit as lump sum. Lump sum taxed on retirement table.	Must buy annuity with at least 2/3rds of non-vested benefit. Lump sum taxed on retirement table.
De minimis exception	N/A	If non-vested benefit ≤ R247 500, can take total non-vested benefit as lump sum. Lump sum taxed on retirement table.

b. Provident fund member on 1 March 2021, 55 or older:

Vested benefit =

i. accumulated benefit up to date of exit

ii. + amounts credited to i

iii. + growth on i and ii

iv. - proportionate section 37D deductions.

Non-vested benefit =

v. contributions after date of transfer to new fund

vi. + amounts credited to v after date of transfer to new fund

vii. + growth on v and vi

viii. - proportionate section 37D deductions.

Provident Fund: member ≥ 55 on 1/3/21; transfers to another fund		
	Pre-transfer vested benefit	Post transfer non-vested benefit
Resignation	Can take total benefit as lump sum. Taxed on withdrawal tax table.	
Retirement	Can take vested benefit as lump sum. Lump sum taxed on retirement table.	Must buy annuity with at least $2/3^{rds}$ of (non-vested) benefit in new fund. Lump sum taxed on retirement table.
De minimis exception	N/A	If non-vested benefit ≤ R247 500, can take total non-vested benefit as lump sum. Lump sum taxed on retirement table.

c. Provident preservation fund member on 1 March 2021, irrespective of age:

Vested benefit =

i. benefit on 1 March 2021

ii. + vested benefits transferred from another fund

iii. + growth on i and ii

iv. - proportionate section 37D deductions.

Non-vested benefit =

v. non-vested benefit transferred from another fund

vi. + growth on v

vii. - proportionate section 37D deductions.

d. Pension, pension preservation and retirement annuity fund member from 1 March 2021, irrespective of age:

Vested benefit =

i. vested benefits transferred from another fund

ii. + growth on i

iii. - proportionate section 37D deductions

Non-vested benefit =

iv. benefit accumulated in fund

v. + non-vested benefit transferred from another fund

vi. + growth on iv and v

vii. - proportionate section 37D deductions.

Impact on receiving fund		
	Vested benefit	Non-vested benefit
Resignation (pension / provident)	Can take total benefit as lump sum. Taxed on withdrawal tax table.	
Retirement	Can take vested benefit as lump sum. Lump sum taxed on retirement table.	Must buy annuity with at least 2/3rds of non-vested benefit + fund benefit. Lump sum taxed on retirement table.
De minimis exception	N/A	If non-vested benefit ≤ R247 500, can take total non-vested benefit + fund benefit as lump sum. Lump sum taxed on retirement table.

A member will be entitled to take their total vested benefit as a lump sum at retirement.

Only the non-vested benefit is subject to annuitisation, which means that if the non-vested benefit is more than R247 500, the member will be limited to a maximum of one-third of that non-vested benefit as a lump sum, with the balance being used to purchase an annuity.

Vested and non-vested benefits will retain their nature when benefits are transferred to another retirement fund, irrespective of the number of transfers. Receiving funds must therefore be able to split benefits into these two separate pots.

A member will still be entitled to take their total benefit, vested and non-vested, as a lump sum when they resign and withdraw from a pension and provident fund, or if they take a pre-retirement withdrawal benefit from a preservation fund.

Following the annuitisation alignment on 1 March 2021, all transfers between funds will be tax-free, except for a transfer from a retirement annuity fund. A retirement annuity fund will be allowed to accept a transfer from any fund but may only transfer to another retirement annuity fund. Tax-free transfers can be summarised as follows:

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

Amendment: The following additional changes have been made in the Taxation Laws Amendment Act No. 27 of 2020 and in subsequent correspondence to clarify previous uncertainties:

a. If a member of a provident fund transfers their benefits to the Government Employees Pension Fund (GEPF), their vested benefits will not remain protected. National Treasury confirmed that this exclusion "is the policy intent and is based on the structure of the current GEPF rules".

b. The calculation of vested benefits is based on net contributions, excluding all administration costs and the premiums to fund insurance benefits. The South African Revenue Service (Sars) confirmed as follows in a non-binding private opinion dated 18 February 2021:

> *"..a contribution, for the purpose of calculating the vested portion of the member's share of fund/retirement benefit in a provident fund, is the net contribution only (i.e. the portion of the contribution*

forming part of the member's share of fund/retirement benefit) after the amount allocated to risk benefits and administration costs, and so forth have been taken into account."

c. If a member of a provident fund is 55 years or older on 1 March 2021 and remains in that fund, his total benefit will remain vested. This means that all contributions made before and after 1 March 2021, as well as all the growth on that, will remain vested. This is illustrated in the table on p2.

Provident Fund: member ≥ 55 on 1/3/21; stays in the same provident fund	
Pre-+ post 1/3/21 benefit = vested benefit	
Resignation	Can take total benefit as lump sum. Taxed on withdrawal tax table.
Retirement	Can take total benefit as lump sum. Lump sum taxed on retirement table.

d. With regards to the question on whether the current wording which refers to "*any amount contributed to a provident fund … prior to 1 March 2021*" includes contributions made in arrears as vested benefits, Sars advised as follows in a non-binding private opinion dated 18 February 2021:

"*The policy intent, as confirmed by National Treasury, relates to members of a provident fund having both contributions and growth subjected to vested right protection irrespective of whether or not the contributions were made or the growth realised on or after 1 March 2021. This means that in a provident fund, arrear contributions are recognised as contributions paid in the month for the month to which they relate.*

Sars is in agreement with National Treasury's view. This is because the member qualified for the deduction in the month in which the contribution was made to the provident fund, irrespective of when the contribution was allocated and received by the provident fund. The contribution is therefore regarded as the contribution for the month of February, including the growth thereon, even though the contributions were only paid to the provident fund in March. Sars therefore also confirms that these contributions to a provident fund will be deemed to have been paid in February and will form part of the vested benefit."

Although the last paragraph only specifically deals with the February 2021 contributions paid in March 2021, it is implied that all arrear contributions payable for periods up to the end of February 2021 should be credited to the provident fund member's vested benefits even though it might only have been paid after 1 March 2021.

e. Deductions under section 37D of the Pension Funds Act, which includes outstanding amounts on housing loan guarantees provided by a fund, compensation for damages caused to an employer due to theft, dishonesty, fraud or misconduct where the member acknowledged liability in writing or the employer obtained a court order demanding such payment, and maintenance and divorce order payments, must be made proportionately from a member's vested and non-vested benefits.

f. In an email to the Association for Savings and Investment South Africa (Asisa) on 18 February 2021, Sars advised that *National Treasury confirmed the policy intent … that the proportional split between the vested and the non-vested benefits is limited to deductions permitted under section 37D of the Pension Funds Act 24 of 1956 and is not applicable to any pre-retirement withdrawal benefits. The request from industry for clarity on the method is an administrative decision that should be taken by the fund administrator and not an interpretational issue. This is because there is no provision in the legislation that specifies the method to be used to deduct the pre-retirement withdrawal."*

The effect of this is that where a member of a provident fund takes a portion of his withdrawal

benefit from the provident fund as a lump sum and transfers the balance to another fund, or where a member of a preservation fund takes a portion his benefit as a pre-retirement withdrawal benefit, the fund is not compelled to split the withdrawal proportionately between the member's vested and non-vested benefits. The fund can for instance take these benefits from the member's non-vested benefit first.

Note: Where a non-member spouse elects to have the amount allocated to them under a divorce order transferred to another fund, it will form part of the non-member spouse's non-vested benefits, irrespective of how the deduction was split between the member's vested and non-vested benefits.

Effective date: 1 March 2021.

2. Deduction of previously disallowed contributions

Background: From 1 March 2016, contributions made by an employer for its employees to a pension, provident and retirement annuity fund are taxed as fringe benefits in the hands of those employees.

The employer is entitled to deduct whatever they contribute for the benefit of their employees to these retirement funds, as long as Sars does not regard the contribution to be excessive in relation to the duties performed by the employee.

A member is entitled to the deduction of the amount specified in section 11F(2) of the Income Tax Act against these contributions. Refer to paragraph B of *Legal Update 13 of 2020: Retirement fund contributions and multiple withdrawals* for more detail on the calculation of the maximum deductible retirement fund contributions. On pension and provident funds, the employer must allow these deductions from the member's remuneration every month in terms of paragraph 2(4)(a) of the Fourth Schedule to the Income Tax Act. The employer may elect to allow a deduction for the member's contributions to a retirement annuity fund if the payment of the contribution is not facilitated by the employer, in terms of paragraph 2(4)(b) of the Fourth Schedule to the Income Tax Act, but is not compelled to do so. Very few employers in fact do this, simply because they do not in fact know whether the employee has paid the contribution to the retirement annuity fund or not. Where the employer, however, makes the retirement annuity fund contribution on behalf of the employee, the employer must take those contributions into account under paragraph 2(4)(bA)) of the Fourth Schedule to the Income Tax Act.

Paragraphs 5 and 6 of the Second Schedule of the Income Tax Act prescribe certain deductions that can be made against a retirement and withdrawal benefit before the benefits are taxed. One of these deductions is "*the person's own contributions that did not rank for a deduction against the person's income in terms of section 11F*". This allows a member to get a deduction of all the contributions that he made to a retirement fund for which he did not previously get a deduction, irrespective of when those contributions were made. The reference to "*the person's own contributions*" limit this deduction to only the contributions made by the member himself, not the contributions made by his employer.

Amendment: Paragraphs 5(1)(a) and 6(1)(b) of the Second Schedule of the Income Tax Act are amended to substitute the reference to "*the person's own contributions*" with "*any contributions*", which allows for the deduction of both employee and employer contributions to be deducted before calculating the taxable portion of a member's lump sum retirement or withdrawal benefit. Section 10C(2) is also amended in the same way.

Note: Only contributions made to a provident fund after 1 March 2016 qualified for deduction in the year that the contributions were made, and accordingly also for the roll over to the next tax year. All employee contributions to a provident fund made before 1 March 2016 and all employee and employer contributions made from 1 March 2016 that did not qualify for deduction after 1 March 2016 qualify for deduction under paragraphs 5(1)(a) and 6(1)(b) of the Second Schedule.

In summary, the following contributions will qualify for deduction under paragraphs 5(1)(a) and 6(1)(b):

a. member contributions to a provident fund before

1 March 2016;

b. member and employer contributions to a provident fund after 1 March 2016 that did not qualify for deduction before;
c. member contributions to a pension fund or retirement annuity fund before 1 March 2016 that did not qualify for a deduction before; and
d. member and employer contributions to a pension fund or retirement annuity fund after 1 March 2016 that did not qualify for a deduction before.

When section 10C was amended in 2020 to allow for the deduction of previously disallowed contributions against an annuity income, it was specifically stated that it was "*applicable in respect of any contributions made to a provident or provident preservation fund in determining the taxable annuity received during any year of assessment from such fund in relation to annuities received on or after 1 March, 2020*". This means that if a member of a provident fund voluntarily decided to annuitise (use a portion of his retirement benefit to purchase an annuity) after 1 March 2020 but before 1 March 2021, only the contributions made after 1 March 2020 would be deductible against his annuity income.

Effective date: This amendment is deemed to have come into effect on 1 March 2016, the same day on which section 11F was introduced.

3. Retail fund withdrawals due to emigration

Background: Before 2008, a member of a retirement annuity fund could only access his benefit in the fund prior to retirement if he became permanently incapable of carrying on his occupation (medical disability) or if his benefit was less than the prescribed minimum of R7 000.

In 2008, the Income Tax Act was changed to allow a member of a retirement annuity fund who emigrated from South Africa before he retired to withdraw his benefit in the fund before retirement. This benefit was taxed on the withdrawal tax table. From 1 March 2016, this pre-retirement access was expanded to include a member who departed from South Africa before his retirement date at the expiry of a visa. The amendment allowed that member to withdraw a lump sum benefit from his retirement annuity fund before his retirement date if he –

a. ceased to be a resident as defined in the Income Tax Act, or
b. left South Africa when his work or visitor visa expired.

A member of a preservation fund has the right to make one withdrawal from the fund before he retires. If he has not exercised that right yet, he will be entitled to a pre-retirement withdrawal if he emigrates or go back to his country of citizenship (repatriates). From 1 March 2019, the Income Tax Act was amended to allow a member of a preservation fund who has already exercised his right to one pre-retirement withdrawal to withdraw his full lump sum benefit when he emigrates from South Africa, if the emigration is recognised by the South African Reserve Bank (Sarb) for the purposes of exchange control, or when he repatriates when his work or visitor visa expires, similar to a member of a retirement annuity fund.

The 2020 Budget Review stated that Government would be modernising the foreign exchange system, which will *inter alia* result in the concept of 'emigration' for exchange control purposes being phased out. The Sarb approval process (via Form MP 336(b) - *Emigration: Application for foreign capital allowance*) will fall away. This has an impact on a member of a retail fund (retirement annuity fund and preservation fund) who up to now had a right to a pre-retirement withdrawal if he emigrated and the emigration was recognised by the Sarb for exchange control purposes. The new test will now be that the member must cease to be a South African tax resident as defined in the Income Tax Act, irrespective of the particular test under which that tax residency is determined, and remain a non-tax resident for at least three consecutive years. It does not focus on just the ordinary resident test.

Amendment: The definitions of 'pension preservation fund', 'provident preservation fund' and 'retirement annuity fund' were amended to allow for pre-retirement access if a member -

a. emigrated and the emigration is recognised by the Sarb for purposes of exchange control, if the application for such Sarb recognition was received on or before 28 February 2021 and approved on or before 28 February 2022, or
b. has been a non-resident for at least three consecutive years on or after 1 March 2021.

The implications of this are as follows:

a. With regards to pending emigration applications as at 1 March 2021, the current process will still apply. This means that a member who has his Form MP 336(b) attested (signed, stamped and dated) by an Authorised Dealer such as a bank on or before 28 February 2021 can still apply for a Tax Compliance Status (TCS) for emigration purposes. TCS will not be granted if the member is not tax compliant (registered for all the required tax types, submitted all tax returns on time and paid all tax debts on time). This application must be approved before 28 February 2022. Once the approval has been received, the member can apply to the fund for access to his benefit based on emigration.
b. From 1 March 2021:
    - Form MP 336(b) will not be applicable any longer.
    - The member will have to request a TCS for purposes of emigration from Sars before an Authorised Dealer will be permitted to transfer any funds.
    - The member must still complete all the Assets and Liabilities as part of his TCS application.
    - Where the assets to be transferred are in excess of R10 million, a stricter verification process will apply, which inter alia means that the application has to be approved by the Sarb and not just an Authorised Dealer.
    - The member must prove to the fund that he has ceased to be a tax resident for three consecutive years. To do this, the member can provide a certificate of residency from the foreign jurisdiction or confirmation that he was not required to submit a tax return in South Africa for the past three years. If a member ceased to be a resident during a specific year of assessment and the information has been provided to Sars, the member's ITR12 will be pre-populated with the date on which he ceased to be a resident. Sars will however not issue a certificate of non-residence. A member can complete the date or cessation of residency himself when he completes his tax return, provided that the date falls within that year of assessment.
    - Sars has indicated that as this process unfolds, the list of acceptable evidence will be expanded.
    - The three years do not start running from 1 March 2021; it must just end after 1 March 2021.
    - Once the fund is satisfied that the member meets the requirements of not being a tax resident for an uninterrupted period of three year, the fund must apply to Sars for a tax directive. The Sars forms will be updated to provide for the information to be submitted to Sars for this purpose. It is important to note that the onus of proving the member's status as a non-resident for tax purposes does not lie with the fund, but with the member. Sars will be able to verify the member's tax status by for instance checking whether any IRP5's or IT3a's were issued in respect of the member or whether the member had a valid bank account in South Africa.
    - The member will then have to provide the TCS from Sars and a document from the fund confirming the final amount of the benefit paid to the member to the Authorised Dealer.
    - The Sars *External Guide on Tax Directive: Emigration and Cessation of Visas*, and the Sarb *Exchange Control Manual* will be updated, hopefully before 1 March 2021.
c. Withdrawals due to the expiry of a visa are not affected and will remain as is. Sars requires confirmation of the following to process such a withdrawal:
    - Was the visa issued in terms of paragraph (b) or (i) of the definition of visa in section 1 of the Immigration Act?
    - Did the visa expire?
    - Did the member exit South Africa?

Effective date: 1 March 2021.

4. Living annuity: termination of trust

Background: Paragraph (e) of the definition of 'living annuity' in section 1 of the Income Tax Act provides as follows:

on the death of the member or former member, the value of the assets referred to in paragraph (a) may be paid to a nominee of the member or former member as an annuity or lump sum or as an annuity and a lump sum, or, in the absence of a nominee, to the deceased's estate as a lump sum.

A trust as a beneficiary is only allowed if the contract allows for it and the beneficiaries of that trust are natural persons. The living annuity contract must stipulate whether it allows a trust to be a beneficiary and must also specify which options the trustees of the trust will have.

Depending on the provisions of the living annuity contract, the trustees of the trust will have the option to choose to:

a. continue with the annuity in the name of the trust;

b. withdraw the annuity as a lump sum; or

c. select a combination of the two options above.

If the trust chooses to continue with the living annuity, a new living annuity contract must be issued in the name of the trust.

The Income Tax Act did not make provision for what should happen when the trust comes to an end before the contract ends because a trust cannot 'die'. It did therefore not allow the trust to make payments to the beneficiaries of the trust when the trust is terminated.

Amendment: A new paragraph (f) was inserted in the definition of 'living annuity' to allow the provider of the living annuity to pay a lump sum to a trust as part of the process of terminating the trust.

A new paragraph 3B was added to the Second Schedule to the Income Tax Act to provide that this lump sum amount will be deemed to have accrued to the trust immediately prior to the termination of the trust. It will therefore be taxable in the trust immediately prior to the date of termination of the trust and not in the hands of the beneficiary. The lump sum will be taxed on the retirement/death tax table. Section 25B of the Income Tax Act was amended to exclude a lump sum benefit payable in terms of the new paragraph 3B from the normal taxation rate (currently 45%) of trusts.

Notes: Sars has confirmed that although there is nothing in law that prohibits a trust from purchasing more than one compulsory annuity from a retirement or death benefit, there will be such a limit if the tax directive applicant is a terminating trust. Such a trust will only be allowed to commute the remaining assets of a living annuity to a lump sum payable to the trust and must complete the form E with the reason 'Par (eA) Living Annuity Commutation Termination of a Trust'. These directive applications may only be applied for via eFiling.

Sars has also confirmed that a terminating trust is not allowed to transfer the annuity to another trust or to a natural person.

Effective date: 1 March 2021.

5. Surviving spouse's pension

Background: The Taxation Laws Amendment Act No. 34 of 2019 amended paragraph 2 of the Fourth Schedule to the Income Tax Act to provide that a retirement fund or an insurer who pays a pension/annuity to an annuitant who receives remuneration from more than one employer, must disregard the tax rebates referred to in section 6 of the Income Tax Act to determine how much tax he/she must withhold if Sars issues a tax directive to that effect. 'Employer' in this context includes a retirement fund or an insurer. Paragraph 1 of Legal Update 3 of 2020 gives more information about this amendment.

Amendment: The initial effective date of 1 March 2021 has been extended to 1 March 2022.

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