

General Note 20 - 14 January 2002

GENERAL SUBJECT: SECOND SCHEDULE TO THE INCOME TAX ACT

SPECIFIC ASPECT: LUMP SUM BENEFITS TO FORMER MEMBERS

STATUS: OPINION

BACKGROUND: This Note should be read with General Note GN18 and General Note GN23

With effect from 29 June 1998 paragraph 2 of the Second Schedule to the Income Tax Act (the Act) was amended to include in gross income, any lump sum benefit received by or accrued to a person in consequence of or following upon past membership of any pension, provident or retirement annuity fund.

The purpose of this change was to accommodate circumstances where lump sum benefits are not necessarily paid by or received from the retirement fund.

It is the purpose of this note to list some of the lump sum benefits that will be affected by this amendment. Lump sum benefits that are not affected by this amendment have also been listed.

OPINION:

1. General Note GN18 provides for the purchase of annuities by retirement funds from registered South African long-term insurance companies. In terms of an annuity purchased on this basis the insurer may provide for the payment of an annuity to the nominees or dependants of deceased annuitants.

The nominee or dependant may, provided certain conditions are met, commute such annuity. The insurer may also provide for certain other lump sum benefits to be paid on the death of the annuitant in consequence of or following upon the annuitant's past membership of the fund. Such a commutation or other lump sum benefit will be a lump sum benefit for purposes of the Second Schedule to the Act and will, therefore, be included in paragraph 2 of the Second Schedule where the lump sum benefit is provided:

- a. directly from the annuity policy; or
- b. by means of a separate policy, where the life cover or lump sum benefit payable on death under the separate policy is linked or related, whether directly or indirectly, to the value of the annuity policy and the cover has been provided in return for no reasonable consideration; or
- c. on any other basis in consequence of or following upon membership or past membership of the retirement fund.

2. Where a lump sum benefit is provided on the death of a former member of a retirement fund by means of a policy under which the cover was provided in return for any consideration provided substantially by the fund, the lump sum benefit will be included in paragraph 2 of the Second Schedule.

3. The following lump sum benefits will not be affected by the relevant amendments

- A lump sum benefit on death under a policy ceded by a retirement fund under the provisions of paragraph 4(2)bis of the Second Schedule to the Act to a former member on resignation or retirement from the fund.
- A lump sum benefit in terms of a separate life policy on the death of a former member of a retirement fund where the former member effected the policy on advantageous terms as a result of his or her cover under the policy issued by the insurer to the retirement fund, provided that paragraphs 1(b) or 1(c) or paragraph 2 above do not apply.
- A lump sum benefit paid in terms of a separate life policy on the death of a former member of a retirement fund where the policy was funded out of an annuity payment accruing to the former member, provided that paragraphs 1(b) or 1(c) or paragraph 2 above do not apply.

ISSUED BY THE SOUTH AFRICAN REVENUE SERVICE

14 January 2002