

General Notes

General Note 22

(Issue 2 with effect from 1 September 2008)

GENERAL SUBJECT: DEFINITION OF BENEFIT FUND

SPECIFIC ASPECT: PARAGRAPH (c) BENEFIT FUNDS

STATUS: OPINION

BACKGROUND: For purposes of this note any reference to a benefit fund means a benefit fund as envisaged by paragraph (c) of the definition of "benefit fund" in section 1 of the Income Tax Act, 1962 (the Act).

With effect from 1 January 2000 a benefit fund as described by paragraph (c) of the definition of "benefit fund" in section 1 of the Act will no longer be recognised as such. This means that contributions to such a fund will no longer be permitted as a deduction under section 11(l) of the Act, the investment growth and other income of such a fund will become subject to income tax, and payments made by such a fund may be subject to income tax in the hands of the beneficiary.

Any benefit fund in existence on 1 January 2000 should, as result, be registered for income tax and employees' tax purposes.

The trustees of a number of these benefit funds are considering options available to them in response to the change in the tax status of benefit funds. The purpose of this Note is to summarise the tax position in general terms relating to some of these options.

It should be noted that the scope and extent of certain decisions and transactions envisaged by trustees are not yet certain and that the South African Revenue Service cannot predict the tax consequences of those decisions and transactions at this stage.

OPINION: *1. Continued exemption of the benefit fund*

As was mentioned before, the tax-exempt status of paragraph (c) benefit funds will fall away on 1 January 2000. Indications are that a number of these funds will seek continued tax exemption under the remaining provisions of section 10 of the Act. It is unlikely that any of these funds will, however, be in compliance with the requirements of the relevant provisions of section 10 of the Act and it is not, therefore, envisaged that exemption would be granted.

2. Registration of a benefit fund as an insurer or a medical scheme (whether directly or through incorporation)

The process of registration of a benefit fund as an insurer in terms of the Long-term Insurance Act, 1998 or as a medical scheme in terms of the Medical Schemes Act, 1998 would not attract income tax in the hands of the participating employer or employees. This would be the case based on the assumption that the employer and/or the members would not, in the process or as a result thereof, become entitled to an amount constituting "gross income" as defined in section 1 of the Act.

It should be noted that –

- benefits provided by a registered medical scheme in respect of medical, dental and similar services, hospital services, nursing services and medicines are, for purposes of the Seventh Schedule to the Act, not regarded as taxable benefits; and

- the proceeds of an insurance policy that are utilised or provided by an employer to defray medical, other expenses or debts of an employee may attract income tax by virtue of the provisions of the Seventh Schedule to the Act.

3. *Winding-up (liquidation) of the benefit fund and transfer of business to a registered medical scheme or long-term insurer*

The winding-up of a benefit fund and the subsequent transfer of assets and liabilities from the fund to a registered medical scheme or to a long-term insurer would in general not attract income tax in the hands of the member or the participating employer. This would be the case based on the assumption that the member and/or the participating employer would not become entitled to an amount constituting "gross income" as defined in section 1 of the Act.

4. *Winding-up (liquidation) of the benefit fund and distribution to employer or members*

It is likely that a distribution by the fund to a participating employer will be included in the employer's income by virtue of the provisions of section 8(4)(a) of the Act.

Save to the extent provided by the provisions of section 8(4)(a) of the Act, it is unlikely that a distribution to a member in direct consequence of the winding-up of the benefit fund would be subject to tax.

Reviewed by the
Legal and Policy Division
SOUTH AFRICAN REVENUE SERVICE
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