

**GENERAL NOTE GN 30**

**GENERAL SUBJECT:** SECOND SCHEDULE TO THE INCOME TAX ACT,  
NO 58 OF 1962

**SPECIFIC ASPECT:** HOUSING LOANS

**STATUS:** OPINION

**PURPOSE:** To convey the view of the South African Revenue Service regarding the tax treatment of a payment made by a retirement fund to redeem a loan that was granted to a member.

**BACKGROUND:** Section 19(5) of the Pension Funds Act, No 24 of 1956 permits a retirement fund to grant a loan to a member or to furnish a guarantee in favour of a moneylender in respect of specified types of loans granted to the member. In certain circumstances the fund is authorised to redeem the loan.

**OPINION:** Loan repayment due to a retirement fund or payment to a third party under a loan guarantee when benefit becomes payable

Subparagraphs (1)(a) and (1)(b) of section 37D of the Pension Funds Act permit a retirement fund to deduct a loan repayment that is due by a member to the fund or to his or her employer, or to deduct the amount for

which the fund became liable under a guarantee for a loan granted to the member, from the benefit payable to the member or a beneficiary. Such a deduction is against the benefit to which the member or beneficiary became entitled and does, therefore, not reduce the taxable portion of the benefit.

Loan repayment due to a retirement fund or payment to a third party under a loan guarantee by order of court

Section 37D(1)(d) of the Pension Funds Act provides for the deduction from a member's benefit or from a member's minimum individual reserve of an amount assigned to another person in terms of a order of court.

Where the court order provides for the deduction of the assigned amount from the benefit of the member, the taxable portion of the benefit is not affected by the deduction. Such a deduction is against the benefit to which the member or beneficiary became entitled and does, therefore, not reduce the taxable portion of the benefit.

To ensure similar treatment where an order is granted for the deduction of the assigned amount from the member's minimum individual reserve in the fund (that is, prior to a benefit becoming due in terms of the rules of the fund), paragraph 2(b) of the Second Schedule to the Income Tax Act provides for the

taxation of the amount of such an order in the hands of the member.

Recovery of employees' tax from the minimum individual reserve

Section 37D(1)(d)(ii) of the Pension Funds Act permits the deduction of employees' tax from the member's minimum individual reserve. Such a payment of employees' tax is also deemed to be a lump sum benefit for purposes of the Second Schedule to the Income Tax Act and thus taxable in the hands of the member.

Determining the amount of employees' tax to deduct from the minimum individual reserve

Determining the correct amount of employees' tax (PAYE) to be deducted from a member's minimum individual reserve is not a precise exercise. Much depends on the member's effective rate of tax, which may be different on assessment to what it was when the tax directive was issued due to the level of information that was available at that time. It should therefore be explained by the member that his or her final tax liability will only be determined on assessment and that the amount of PAYE deducted from his or her minimum individual reserve may not be correct.

Where a fund deducts the employees' tax (that is, payable on the amount paid in terms of a valid court

order) from the member's minimum individual reserve, an additional lump sum benefit is deemed to accrue to the member in terms of the provisions of the Second Schedule to the Income Tax Act. This additional lump sum benefit, which is equal in value to the employees' tax paid on the amount of the court order, will require another application for a tax directive. The tax-on-tax effect that the deduction from the minimum individual reserve creates would ordinarily result in the fund administrator having to apply for a tax directive on each layer of additional tax. To alleviate this burden, the use of the following formula to determine the additional amount in respect of which another application for a tax directive must be made is accepted by SARS:

$$X = A / C \times B$$

where

X = represents the amount for which an additional tax directive must be applied for

A = the tax deductible as per the first tax directive tax

B = 100

C = 100 minus the member's effective rate of tax\* as determined by the first tax directive.

**\* the effective rate = PAYE as per first directive divided by the amount of the order of court**

### **Example**

The amount payable to the non-member spouse in terms of the court order is R50 000. As determined

by the tax directive received by the fund from SARS, the PAYE on this amount is R15 000. The effective rate of tax as determined by SARS in respect of the member is therefore 30% (R15 000 / R50 000).

The additional amount that must be deducted from the member's minimum individual reserve to cover both the R15 000 and the additional lump sum benefits that are caused by the tax-on-tax effect of paying for the PAYE out of the minimum individual reserve can therefore be determined as follows:

$$A = 15\,000$$

$$B = 100$$

$$C = 100 - 30$$

$$X = R15000 / 70 \times 100$$

$$X = R21428$$

An additional (2<sup>nd</sup>) application for a tax directive must then be obtained on the amount of R21 428. Assuming the average remained the same, the tax directive that is received back would reflect PAYE of R6 428 on the R21 428. The PAYE of R6 428, together with the initial PAYE of R15 000, adds up to R21 428.

The total amount to be deducted by the fund from the minimum individual reserve of the member is therefore R71 428 (R50 000 + R21 428).

The IRP5-certificate of the member must be completed as follows:

Code 3902      R50 000

Code 3902      R21 428

Code 4102      R21 428

**Issued by –**

**LEGAL AND POLICY DIVISION**

**SOUTH AFRICAN REVENUE SERVICE**

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