

GENERAL NOTE GN16

GENERAL SUBJECT: RETIREMENT FROM EMPLOYMENT

SPECIFIC ASPECT: COMMUTATION OF SMALL ANNUITIES

STATUS: DECISION

BACKGROUND: The provisions of paragraphs (c)(ii)(a) of the definition of "pension fund" in section 1 of the Income Tax Act (the Act) and (b)(ii) of the definition of "retirement annuity fund" in section 1 of the Act provide for the commutation of not more than one-third of the total value of the annuity to which an employee or member, respectively, becomes entitled and provide, furthermore, for the full commutation of an annuity if the annual amount of the annuity does not exceed R1800 per year.

DECISION: The annuity factor

If the rules of an approved pension or retirement annuity fund in any form prescribe or indicate the annuity factor that is to be used to determine the annuity to which a member will become entitled on retirement, that prescribed annuity factor must be used to determine whether the member may commute more than one-third of the annuity to which he or she becomes entitled.

If the rules of such a fund do not prescribe or indicate an annuity factor on the aforementioned basis, an annuity factor not exceeding 12.5 must be used by the

fund to determine whether or not the member may commute more than one-third of the annuity to which he or she becomes entitled.

2. New annuities

2.1 Approved pension fund

If the annuity which is produced by the aforementioned annuity factor exceeds R1800 per year, the annuity may not be commuted in full. If the annuity so produced does not exceed R1800 per year, and the annuity factor does not exceed 12, the annuity may be commuted in full.

2.2 Approved retirement annuity fund

If the annuity which is produced by the aforementioned annuity factor exceeds R1800 per year, the annuity may not be commuted in full. If the annuity so produced does not exceed R1800 per year, and the annuity factor does not exceed 12.5, the annuity may be commuted in full.

No annuity may be commuted after 6 months of the death of the member.

3. Existing annuities

If a retirement fund administrator in respect of a member of an approved pension or retirement annuity fund is able to prove that a portion of an annuity

payable to the member had not been commuted in the past in terms of the rules of the fund, the annuitant may commute the annuity for a single payment if it does not exceed R1800 per annum and if the annuity factor does not exceed 12.5.

If a retirement fund administrator in respect of a member cannot prove that a portion of the annuity payable to the member had not been commuted in the past and the annuity, with an annuity factor not exceeding 12.5 does not exceed R1800 per year, the annuity may be commuted for a single payment subject to such additional administrative arrangements as this office may determine.

Examples

- a) The annuity factor is 10.00. The total value of the annuity is R20000. The annuity factor produces an annual annuity of R2000, which is in excess of R1800. Only one-third of the total annuity may, as a result, be commuted.
- b) The annuity factor determined is 12.50. The total value of the annuity is R20000. The annuity factor produces an annual annuity of R1600, which does not exceed R1800. The full three-thirds of the total annuity may, as a result, be commuted.
- c) The annuity factor determined is 12.50. The total value of the annuity is R50000. The annuity factor produces an annual annuity of R4000, which exceeds R1800. Only one-third of the total annuity may, as a result, be commuted.

4. General

4.1 Any lump sum benefit that becomes payable by an approved pension, provident or retirement annuity fund is subject to the provisions of paragraph (e) of the definition of "gross income" in section 1 of the Act.

4.2 The administrator of a fund must apply for a tax directive relating to the full commutation of an annuity, provide a calculation of the annual annuity to which a member became entitled and must specify whether or not any previous commutations in relation to the member's membership of the fund were made.

4.3 In the case of an approved pension fund, an annuity payable to the dependant(s) or nominee(s) of a deceased member may be commuted in full within 6 months of the death of the member notwithstanding the value of the annual annuity. In the case of an approved pension fund or approved retirement annuity fund, no annuity may be commuted after 6 months of the death of the member.

4.4 The contents of this note will have effect from 15 September 1997 and may be revised by the Commissioner from time to time.

ISSUED BY THE SOUTH AFRICAN REVENUE SERVICE

15 September 1997