

GENERAL NOTE GN 35

GENERAL SUBJECT: PENSION FUNDS AND PROVIDENT FUNDS

SPECIFIC ASPECT: UNCLAIMED BENEFITS

STATUS: CONFIRMATION

BACKGROUND

& CONFIRMATION:

The purpose of this Note is to confirm the requirements of the South African Revenue Service relating to the treatment by pension and provident fund trustees or administrators of unclaimed benefits that arise in consequence of the termination of employment.

It is often the case that a beneficiary who has become entitled to a benefit in terms of the rules of a retirement fund does not claim the benefit. In such a case, fund administrators often classify this benefit as an “unclaimed benefit” after the expiry of a period. The factors determining how and when a benefit becomes unclaimed differ from administrator to administrator.

Until last year most administrators only processed an unclaimed benefit for employees’ tax purposes when it is eventually claimed by the beneficiary. From a tax point of view, this practice meant that administrators applied for tax directives in respect of employees’ tax on these benefits only when the beneficiary claimed the benefit, and not when the benefit accrued for tax purposes.

What is an unclaimed benefit?

A benefit would typically become unclaimed when the beneficiary for some reason fails to claim the benefit within a reasonable period after the benefit has accrued. For tax administration purposes a reasonable period is regarded as a period of up to 6 months from the date of accrual of the benefit (i.e. up to 6 months from the day after resignation / termination of employment or retirement, or up to 6 months from the day before death). After this period, the benefit is regarded by SARS as unclaimed.

When does an unclaimed benefit accrue for tax purposes?

In terms of most fund rules a beneficiary becomes unconditionally entitled to claim a benefit on the day after the exit event (i.e. on the day after resignation / termination of employment or retirement).

The right to claim the benefit is sufficient to create an accrual for tax purposes. The accrual occurs notwithstanding the fact that the beneficiary has not claimed the benefit.

The fact that a beneficiary has not completed administrative requirements in respect of his or her claim, or the fact that the administrator is unable to trace the beneficiary or unable to determine whether or not the beneficiary will exercise some choice in respect of the payment of the benefit does not affect the beneficiary's unconditional right to claim the benefit.

Similarly, the fact that a member has a right to elect to transfer the benefit to another fund but fails to exercise that right does not affect the unconditional accrual of the benefit.

A member of a pension fund that elected to commute a portion of his or her annuity in favour of a lump sum benefit will generally have become entitled to claim the benefit and the

benefit will therefore accrue. In the case of a provident fund, a lump sum benefit that is paid or payable on retirement accrues on the day after the date of retirement.

In the case of a death benefit, the benefit is deemed (for income tax purposes) to accrue to the deceased member on the day before he or she died.

Where a benefit became "paid-up" but the beneficiary has a right to elect to receive the paid-up benefit prior to normal retirement date, it is not regarded as a true "paid-up" benefit, which means that the benefit would have accrued on the day after the exit event (i.e. on the day after resignation / termination of employment or retirement).

Attempts to structure or restructure the rules of a retirement fund to defer the accrual of a benefit (other than a deferral on a true "paid-up" basis) will not be approved by SARS. Where such a rule exists it is the responsibility of trustees to ensure that the rule is removed or appropriately amended on or before 30 June 2004, failing which the approval of the fund will be withdrawn by SARS.

When must employees' tax be deducted?

In respect of a lump sum benefit, the provisions of paragraphs 2(1) and 9(3) of the Fourth Schedule to the Income Tax Act (the Act) require the fund or the administrator of the fund to apply for a tax directive at SARS when the fund pays or becomes liable to pay the benefit. The administrator becomes liable to pay when the benefit accrues.

In July 2003 SARS became aware that some funds and administrators were not deducting employees' tax from unclaimed benefits, and launched a project in terms of which these funds and administrators were required to pay the outstanding employees' tax. Funds and administrators were required to prepare IRP5-certificates in this regard, and were individually advised on these requirements.

The growth subsequent to the taxation of the benefits under the 2003-project or subsequent to the taxation of future unclaimed benefits

Where interest accrues (or is deemed to accrue under the provisions of the Income Tax Act) to the beneficiary of an unclaimed benefit the fund or administrator must issue an IT3(b) in respect of each year of assessment.

New unclaimed benefits arising subsequent to the 2003-project

Funds and administrators must apply for and deduct employees' tax as and when a benefit accrues in terms of the rules of a fund or is deemed to accrue (i.e. upon resignation / termination of employment or retirement or death).

For administrative purposes, it is accepted by SARS that a fund may in unusual circumstances wish to delay the application for a tax directive for a period of up to six months after the benefit accrued to ensure accurate processing of a claim. The year of assessment in which the benefit accrued must, however, remain the year in which the benefit accrued.

Must another tax directive be obtained when the

beneficiary eventually claims an unclaimed benefit?

Where:

1. a fund or administrator applied for a tax directive in respect of an unclaimed benefit that arose after the 2003-project; **and**
2. the application was made on the basis described in this Note; **and**
3. a directive was received in response to the application; **and**
4. an IRP5 or IT3(a) certificate was prepared in respect of the benefit that reflects the contents of the directive; **and**
5. the investment growth until the date of actual payment represents interest and was reflected as such per IT3(b) as prescribed in this Note; **and**
6. no benefit in addition to or greater than the original benefit payable on the date of accrual is payable,

the fund or administrator is not required to apply for and obtain another tax directive when the beneficiary eventually claims the unclaimed benefit. The unclaimed benefit can therefore be paid, as long as the IRP5 or IT3(a) certificate is also handed to the beneficiary on payment.

Where a beneficiary claims an unclaimed benefit that was subject to employees' tax under the 2003-project, the fund or administrator must apply for a tax directive in respect of the benefit. The next paragraph explains this in more detail.

What if the beneficiary claims the unclaimed benefit but employees' tax has already been paid to SARS under the 2003-project?

Where an unclaimed benefit that was subject to employees' tax under the 2003-project is eventually claimed, the fund or administrator must apply for a tax directive on the total amount of the lump sum benefit. The amount of employees' tax

payable to SARS in terms of the tax directive must be reduced by the amount of employees' tax already paid under the 2003-project, and the difference must be paid to SARS. An IRP5 must be completed to reflect the difference. On the income side, the IRP5 must reflect the difference between the original lump sum benefit (i.e. the benefit that was already taxed under the 2003-project) and the lump sum benefit actually paid.

If the fund or administrator is unsure whether or not an IRP5-certificate was completed in the past, or whether employees' tax was deducted under the 2003-project, the IRP5-certificate must reflect the total benefit and the amount of employees' tax deducted as per the latest tax directive.

What if the beneficiary claims the unclaimed benefit and elects to transfer to another fund?

The Second Schedule to the Act provides a deduction in respect of a transfer to another qualifying fund. This deduction is, however, only available in respect of the year of assessment in which the benefit accrues (i.e. in the year of resignation). The effect of this is that where a beneficiary failed to elect to transfer to another fund in the year of assessment during which the benefit accrued, the deduction falls away. For administrative purposes it is accepted that an election within 6 months after the date of accrual still relates to the year of assessment in which the benefit accrued, even though the date on which the election was made is in the following year of assessment.

What about "pending" tax directives?

Where a tax directive is declined and the reason is indicated as **"Contact your nearest Receiver of Revenue"**, the administrator must advise the beneficiary to do so.

What if the fund has unclaimed benefits that have never

been subject to employees' tax

Any fund with unclaimed benefits that have not been subject to employees' tax under the 2003 project must submit data on these benefits to SARS to the following address:

Room AG91
299 Bronkhorst Street
Nieuw Muckleneuk
0181

The data must be submitted on or before 31 May 2004. Failure to do so will result in penalties and interest.

Other issues

Some issues relating to unclaimed benefits may become more significant in the future and will be addressed by way of addendums to this Note.

ISSUED BY THE SOUTH AFRICAN REVENUE SERVICE

8 April 2004