GENERAL NOTE GN29

GENERAL SUBJECT: **SECOND SCHEDULE TO THE INCOME TAX ACT**

SPECIFIC ASPECT: **APPORTIONMENT OF SURPLUS AND MINIMUM BENEFIT REQUIREMENTS - PENSION FUNDS SECOND AMENDMENT ACT**

STATUS: **OPINION**

BACKGROUND: The Pension Funds Second Amendment Act (Act No. 39 of 2001) came into operation on 7 December 2001. The Act introduced minimum benefits and requires retirement funds to apportion actuarial surplus between stakeholders (current members, former members and the employer).

OPINION: The tax consequences relating to some of these changes are as follows:

1. **Distribution to persons who retired from the retirement fund prior to the surplus apportionment date.**

   1.1 <u>Distribution by way of lump sum payment (provident funds only)</u>

   A distribution in the form of a lump sum payment will be taxable under the provisions of the Second Schedule to the Income Tax Act (the Act). The payment will not be in consequence of or following upon retirement, death or withdrawal from the fund, and no deduction under the Second Schedule against the lump sum payment will therefore be available. The average rate of tax as determined in terms of section 5(10) of the Act will be applicable.

1.2 <u>Distribution by way of an additional pension</u>

A distribution in the form of an additional pension will be taxable as a pension.

The requirements for approval of a pension fund do not permit the trustees of a fund approved as a pension fund to pay a surplus apportionment to retired members by way of a lump sum. A surplus apportionment in respect of these members may therefore only be distributed by way of an increase in the existing pension. The provisions of GN19 continue to apply in these circumstances, and no commutation of the additional pension is permissible under current legislation.

Where an existing pension was purchased from a long-term insurer as envisaged in General Note GN18 and where the long-term insurer, for reasons beyond its control, cannot reasonably be expected to accept the surplus apportionment as payment for an increase under the existing pension arrangement, the fund that originally purchased the pension or the long-term insurer may pay the surplus apportionment to the member in the form of a once-off bonus pension. A distribution in the form of a once-off pension bonus will not be subject to the provisions of the Second Schedule to the Act and will be taxable in full at the member's marginal rate of tax. Whether the pension bonus is paid by the fund or the long-term insurer, employees' tax on the pension bonus must be calculated after taking the existing pension into account.

2. **Distribution to active members**

   An increase in the retirement, withdrawal or death benefit of a member is taxable as and when the member becomes entitled to any of these benefits in terms of the rules of the fund. The relevant deductions provided in terms of the Second Schedule to the Act will be available as normal.

3. **Distribution to former members who withdrew from membership (as opposed to retire) prior to the surplus apportionment date**

   A distribution in the form of a lump sum payment will be taxable under the provisions of the Second Schedule to the Act. The payment will not be in consequence of or following upon retirement, death or withdrawal from the fund, and no deduction under the Second Schedule against the lump sum payment will therefore be available. The average rate of tax as determined in terms of section 5(10) of the Act will be applicable.

4. **The date of accrual of a surplus apportionment**

   4.1 In respect of persons who retired from the retirement fund prior to the surplus apportionment date, or former members who withdrew from membership prior to the surplus apportionment date, the date of accrual of a surplus apportionment would in general be the date on which the person becomes unconditionally entitled to the surplus apportionment. In general, this would be the date on which the Financial Services Board approved the scheme as envisaged under the Pension Funds Act.

   4.2 A surplus apportionment and distribution will not be in consequence of or following upon the member's withdrawal or resignation, and the provisions of paragraph 4(1) of the Second Schedule to the Act will, therefore, not apply.

5. **General**

5.1 In accordance with paragraph 9(3) of the Fourth Schedule to the Act, the fund must apply for a tax directive before paying a lump sum benefit. The application must be made on a **Form B** and the "reason for directive" must be marked as "**surplus apportionment**".

5.2 To the extent that section 7A of the Act applies, the taxpayer will have the right to be treated in accordance with that section.

5.3 A translocation to a preservation fund in respect of a person who retired or a former member is not currently permitted in terms of Retirement Fund Practice Note RF1/98.

5.4 Paragraph 2 of Retirement Fund Practice Note RF1/95, requires the approval of the South African Revenue Service where the member's benefit is increased by more than 10 per cent. Where a surplus apportionment or minimum benefit increase amounts to more than 10% of the benefit, the requirement for approval will not apply.

5.5 Where an employer is required to meet a deficit under a surplus apportionment scheme or under minimum benefit requirements, the contribution will rank for deduction under section 11(l) of the Act and a deduction will be subject to the provisos to that section.

ISSUED BY THE SOUTH AFRICAN REVENUE SERVICE
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