

Retirement Fund Practice Note RF 1/98 (Preservation Funds)

SARS Practice Note RF 1/98

Funds for the preservation of the retirement interests of employees

The purpose of this practice note is to lay down conditions under which so-called preservation funds will be approved for the purposes of the Income Tax Act. This practice note replaces Practice Note RF1/93 with effect from 30 November 1998.

By preservation pension and provident funds is understood vehicles for the preservation of retirement benefits of employees who cease to be members of an approved pension or provident fund in which the member's employer participates [hereinafter referred to as an employer fund (other than a preservation fund)] as a result of resignation from employment, retrenchment or dismissal from employment or the winding up of such a fund.

Resignation, retrenchment, dismissal or winding-up benefits from employer funds are collectively designated "translocation benefits" for purposes of this note. The contents of the Note apply to each translocation benefit paid or payable into a preservation fund for the benefit of a member.

1. Participating employer

In addition to its participation in an employer fund established for its employees, the employer must be a participating employer in the preservation fund. To participate in a preservation fund, the trustees of the preservation fund must have accepted a written application from the employer to participate in the fund and the trustees must have approved the employer's participation. Participation must commence on the date on which the trustees of the preservation fund approve the employer's participation.

2. Eligibility for membership

2.1 Membership of a preservation fund is dependent upon the employee being eligible for membership. Eligibility for membership of a pension preservation fund is only possible if the potential member is an employee of an employer who participates as an employer in the pension preservation fund and if the potential member is a member of the employer's pension fund. Similarly, eligibility for membership of a provident preservation fund is only possible if the potential member is an employee of an employer who participates as an employer in the provident preservation fund and if the potential member is a member of the employer's provident fund. Being an employee, for purposes of membership of a preservation fund, means that the potential member is currently in the employment of the participating employer.

2.2 It is not permissible for a person's membership of a preservation fund to be made effective retrospectively from a date preceding his or her actual date of resignation or retrenchment or the date of winding up of the previous fund. Nor may such membership become effective from a date preceding the employer's actual date of participation. Backdating of employee membership or employer participation will result in the approval of a preservation fund being withdrawn.

2.3 A preservation fund's eligibility conditions in respect of a participating employer must duplicate the eligibility requirements of the employer's retirement fund. Employees already in the employer's service may have an option to become members within a period of 12 months from the date of the employer's participation in the preservation fund.

2.4 A member of the employer fund may become a member of any preservation fund in which his employer participates, but a translocation benefit may only be paid into a single preservation fund to which the employee belongs. Splitting of translocation benefits is, therefore, not permissible.

3. Translocation of benefits

3.1 Translocation of benefits to a preservation fund

Translocation benefits may be paid to a preservation fund if a member bona fide resigns from the employment of his employer or is retrenched or dismissed from employment or if the whole business of the fund, or the portion thereof that is attributable to members in the present or past employment of a particular employer, is winding-up in terms of section 28 or 29 of the Pension Funds Act.

The translocation benefits resulting from an employee's membership of more than one employer fund may respectively be paid to more than one preservation fund of which the employee is a member and in which the employer participates. For example, if the employee is a member of both the employer's pension and provident funds, the translocation benefit in the pension fund may be paid to a pension preservation fund while the translocation benefit in the employer provident fund may be paid to a provident preservation fund, subject to all the relevant requirements having been satisfied.

No translocation to a preservation fund is permitted in circumstances where an employer has either merged with or been taken over by another entity and where an employee of that employer enters in employment with the merged employer or entity.

3.2 The amount paid into a preservation fund

A member of an employer fund in respect of which a translocation benefit becomes available from that fund may, if the rules of the employer fund so provide, have a portion of the translocation benefit paid into an approved retirement annuity fund by way of a direct payment as contemplated by the provisions of paragraph 6 of the Second Schedule to the Income Tax Act. The negative effect on symbol "N" as explained in paragraph 7 below should be noted.

The remaining portion of the translocation benefit or, if no amount is paid into a retirement annuity fund, the gross translocation benefit value of a member who opts to translocate must be paid into the preservation fund.

A preservation fund may, furthermore, not receive member contributions, and may only receive direct payments from other approved retirement funds or public sector retirement funds.

3.3 Translocations between preservation funds

The benefits of a member of a pension preservation fund may be paid into another pension preservation fund, and the benefits of a member of a provident preservation fund may be paid into another provident preservation fund, if the member is a member of the other preservation fund by virtue of current employment, and if the total remaining benefits are paid into such other preservation fund. If such a transferring member has already been granted a withdrawal benefit in the circumstances described in paragraph 5 below, the trustees of the preservation fund effecting the translocation must instruct the trustees of the preservation fund accepting the translocation benefit to prohibit the member from receiving or becoming entitled to any benefit prior to the date or age referred to in paragraph 4 below. The trustees of the preservation fund effecting the translocation must ensure that the trustees of the preservation fund accepting the translocation benefit have duly recorded the instruction.

3.4 Translocation from a preservation fund to another approved fund (not a preservation fund)

The benefits of a member of a preservation fund who is in new employment may, irrespective of whether the preservation fund paid a withdrawal benefit to the member in the past, be paid into the approved pension or provident fund in which his or her new employer participates if he or she is a member of the new fund. The member's full benefits, less income tax if the translocation occurs from a preservation pension fund to a provident fund, must be paid into the new fund and will be subject to the rules of the new fund.

No transfer from a preservation fund to a retirement annuity fund is permitted.

3.5 Translocation from pension to provident fund in terms of the "14 September 1990 arrangement"

No payment to a preservation fund may be effected during a translocation of benefits from a pension fund to a provident fund in terms of the 14 September 1990 arrangement.

4. Disability, early retirement and normal retirement benefits

The paid-up benefit in a preservation fund must be paid in the form of a retirement benefit with effect from the date of the member's actual retirement from his employment with the employer in whose service he is when he retires. A member who is not in employment and who wishes to take a retirement benefit may do so before he reaches the age of 70 years, but not before he reaches the age of 55 years.

If, as a result of disability, an employee is retired from his or her new employment prior to attaining normal retirement age, the member must become entitled to a retirement benefit from the preservation fund, whether or not the age of 55 years was attained.

If the member is not in employment, the benefit in the preservation fund must, save for the option to become entitled to a withdrawal benefit as prescribed in paragraph 5 below, remain paid-up until he or she attains the age of 55 years, unless the trustees of the preservation fund are satisfied that the member has become permanently disabled through infirmity of mind or body, in which event an early retirement benefit may become payable.

5. Withdrawal benefits from the preservation fund

No more than one withdrawal benefit may be paid by the preservation fund.

The rules of the preservation fund should provide for the payment of a withdrawal benefit at a fixed or ascertainable future date as contemplated in paragraph 4(1) of the Second Schedule to the Income Tax Act where the benefit is not paid on the date of withdrawal from the employer fund. If a withdrawal benefit or balance of a withdrawal benefit is retained in the preservation fund beyond the fixed or ascertainable future date it must be made paid-up and no further withdrawals may be permitted.

Any amount deducted from the translocation benefit (excluding a transfer to a retirement annuity fund as envisaged above), including deductions in terms of section 37D of the Pension Funds Act, is regarded as the member's first and final withdrawal benefit from the preservation fund. As uncertainty in this regard existed the South African Revenue Service may be approached by the trustees of a preservation fund for a ruling in cases where, prior to 1 December 1997, only a portion of the translocation benefits was paid into the preservation fund and where the trustees can prove that a member was not informed accordingly.

6. Taxation of a translocation benefit

The translocation of benefits from an employer pension fund to a preservation pension fund, or from an employer provident fund to a preservation provident fund will not, by virtue of the provisions of paragraph 6 of the Second Schedule to the Act, attract income tax.

7. Transfer of "N" factor for purposes of the Second Schedule to the Income Tax Act

A member's years of service or membership, as the case may be, relative to an employer fund may be translocated to the preservation fund and the provisions of section 11(k)(ii)(dd) of the Income Tax Act will be applicable. The rules of the preservation fund must provide for the purchase of the past service, and the gross translocation benefit must be utilised to fund the purchase for symbol "N" to have a value equal to what it was in the employer fund. If a lesser amount is translocated, the number of years represented by symbol "N" must be reduced proportionally. A member's withdrawal benefit from the preservation fund prior to retirement must, on a pro-rata basis, reduce the number of years represented by symbol N.

8. Use of preservation funds as a tax deferral vehicle

The trustees of a preservation fund may not disseminate, or cause or permit the dissemination of marketing material or marketing presentations or similar actions which promote a preservation fund or preservation funds in general as a facility to reduce a member's average rate of tax for purposes of section 5(10) of the Income Tax Act. Actions of this nature will cause the preservation fund's approval to be withdrawn.

9. General

Preservation funds must ensure that their rules comply with the requirements of this note. Should amendments be necessary in this regard, they must be submitted for approval before 30 January 1999 or such later date as has, prior to that date, been agreed with this office.

ISSUED BY THE SOUTH AFRICAN REVENUE SERVICE

30 November 1998