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BINDING GENERAL RULING ON PURCHASING ANNUITIES AT RETIREMENT

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Introduction

The South African Revenue Service (SARS) recently published a binding general ruling (hereinafter referred to as “the Ruling”) on the purchase of different types of annuities at retirement from a retirement fund.

In this edition we will unpack the implications of this Ruling.

Context

To put the Ruling in context, we first need to take a step back.

At retirement, a member of a retirement fund - *depending on the definition of the fund in question as set out in section 1 of the Income Tax Act* - is typically entitled to withdraw up to a maximum of one-third of the underlying fund value as a lump sum. A minimum of two-thirds of this value must be used to buy a compulsory annuity.

This compulsory annuity can be provided by the retirement fund (“fund owned annuity”) or, alternatively, the retirement fund can transfer the obligation to provide an annuity to a registered insurer (“member

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owned annuity”). Furthermore, the annuity to be provided may, depending on the former member’s election, either be a conventional annuity or a living annuity as defined in section 1 of the Income tax Act.

The Income Tax Act however, does not prescribe whether the annuity must be provided by the retirement fund or purchased from an insurer, nor does it prescribe the nature or characteristics of such an annuity.

The withdrawal of SARS General Notes 18 and 18A

Previously, General Notes 18 and 18A (issued by SARS under the Income Tax Act, 1962) set out the requirements in respect of annuities purchased on the retirement of a member of a retirement fund.

General Note 18 allowed for retirement funds to purchase an annuity from an insurer in the name and on the life of a member who is retiring from the fund. It stated that, for income tax purposes, the annuity purchased had to be compulsory, non-commutable, payable for and based on the life of the retiring member. This meant that the annuity may not be transferred, assigned, reduced, hypothecated or attached by creditors as contemplated by the provisions to sections 37A and 37B of the Pension Funds Act No. 24 of 1956. (**Section 37A of the Pension Funds Act specifically states that a benefit provided for in the rules of a registered pension fund, or a right to such benefit, shall not - save for certain exceptions - be capable of being reduced, transferred or otherwise ceded, or of being pledged or hypothecated, or be liable to be attached or subjected to any form of execution*).

In addition, General Note 18 also provided that a member could not choose a **combination** of an annuity provided by the fund and an annuity purchased from an insurer – in other words, the retiring member had to **choose the one or the other**.

Compliance with the requirements of General Note 18 was necessary in order for retirement funds to retain its approval by SARS in terms of the Income Tax Act, as is stated in General Note 18.

In February 2021 SARS withdrew both General Notes 18 and 18A, thereby creating uncertainty regarding the requirements applicable to such annuities. The withdrawal of General Notes 18 and 18A however meant that as of February 2021 the combination of annuities is no longer disallowed, and that a member could choose a combination of an annuity provided by the **fund** and an annuity purchased from an **insurer**. The industry welcomed this change and made several submissions to Treasury and SARS in this regard.

The Ruling

On 4 November 2021 SARS published the Ruling with the aim of resolving the uncertainty caused by the withdrawal of General Notes 18 and 18A.

In essence, it confirms that the rules of retirement funds may provide for:

- a) the retirement fund paying the annuity directly;
- b) purchasing the annuity in the name of the retirement fund;
- c) purchasing the annuity in the name of a retiring member; and
- d) **any combination of the above methods**.

The ruling further confirms that multiple annuities of each of the above annuity types may be provided for in the rules of the fund.

Lastly, it confirms that an annuity provided on retirement:

- a) may not be transferred, assigned, reduced, hypothecated or attached by creditors; and
- b) must be compulsory, non-commutable, payable for and based on the lifetime of the retiring member (as prescribed by section 37A of the Pension Funds Act).

Conclusion

This Ruling constitutes a binding general ruling issued under section 89 of the Tax Administration Act 28 of 2011 and applies from 26 February 2021, being the date of the withdrawal of GN18 and GN18A (**take note: it does not apply retrospectively*).

The effect of this Ruling will have to be considered by the board of trustees of retirement funds and any consequential changes to a fund's annuity strategy as set out Regulation 39 will need to be considered by the board.