Taxation Laws Amendment Act No. 23 of 2018

By Lize de la Harpe, Legal Adviser

In 2017, the Income Tax Act was amended to allow employees to transfer their benefits from employer pension or provident funds to a retirement annuity fund on or after reaching normal retirement age, *but before retirement date*. These amendments increased the choice of available retirement funds in cases where individuals decided to postpone retirement.

Transfers to *pension- and provident preservation funds*, however, remained excluded for the fear that it would be administratively burdensome since it could result in the withdrawal of all benefits as a lump sum, rather than the preservation of funds.

This has now been changed - the Taxation Laws Amendment Act No. 23 of 2018 ("the TLAA"), as published on 17 January 2019, has extended this option to include preservation funds as well. In this edition we will unpack these changes and the implications thereof on preservation funds.

Background

During retirement, individuals who are members of a retirement fund have the option to either annuitise the entire pension fund interest or take up to one third of it as a lump sum (depending on the type of fund). Where the individual:

1. annuitises a portion of the benefit, the *annuities* are taxed as normal income according to the individual's marginal tax rate;
2. elects to take a portion of the benefit as a lump sum, the *lump sum* is taxed according the retirement fund lump sum benefit table.

Accordingly, at the date of retirement, members are compelled to make an election as to the portion of their retirement interest that they would like to receive as a lump sum and as an annuity. The fund, in turn, then has to apply to SARS for a tax directive to determine the amount of tax that must be withheld from the lump sum payment to the retiring member.

The lump sum benefit is deemed to accrue to the individual on the earliest of the dates at which an election is made, a transfer is made, death, or on his or her retirement.

The position prior to March 2015

Prior to March 2015, retirement was deemed to occur at the '*normal retirement age'* as defined by the fund rules.

This often led to complications, for example, in instances where (by the date of retirement) the member had not yet made an election as to the amount of the retirement fund interest he/she wants to take as a lump sum – rendering the fund unable to calculate/withhold the required amount of income tax, thus falling foul of the withholding obligations.

Adding to the problem: the amount of the lump sum as provided to SARS in the tax directive is based on the *amount in the fund on the date of accrual* - which amount may differ at the time that the individual *actually makes an election*.

In addition to the above, members were offered little flexibility with regards to *when* they would like to start receiving their pension benefits. Since retirement was determined by the normal retirement age of the fund, members could not choose to continue working beyond their normal retirement age thereby preserving retirement fund assets at retirement.

The changes to the tax treatment of "retirement interest"

The above stance was however changed by the Taxation Laws Amendment Act of 2014 which amended the date on which the lump sum benefits are deemed to accrue. As of 01 March 2015, the date on which a lump sum benefit accrues to the member at retirement is no longer triggered by the "*normal retirement age*" as set out in the fund rules – *it will only accrue on the date that the member elects to receive it (i.e.: when it becomes payable)*. As a result, retirement funds have to apply to SARS for a tax directive on the date that the election is made.

The definition of "*Retirement Date*" was accordingly amended to state that a member's retirement date will be the date on which he or she *elects to retire* in terms of the rules of their fund and the definition of "*Retirement Interest*", in turn, was amended to refer to the member's share (of the fund per the fund's rules) *on the date on which "he or she elects to retire*".

Reaching retirement age

Currently, when a pension/provident fund member chooses to defer his/her retirement date after reaching normal retirement age (but before retirement date), he can either:

- remain a deferred retiree of the employer pension or provident fund; or
- *transfer the retirement interest benefit to a retirement annuity fund.*

To date, the transfer of a retirement interest benefit to a *preservation fund* is not possible. The reason therefor lies in the current wording of the Income Tax Act, specifically the definition of preservation funds (as set out in section 1 of the Income Tax Act) which limits it to withdrawal benefits.

The changes from 01 March 2019

The TLAA 2018 has amended the Income Tax Act to make provision for the member, when reaching retirement age (but before retirement date), to transfer his/her retirement interest to a preservation fund as well:

- the definitions of both "*pension preservation fund*" and "*provident preservation fund*" have been amended to extend membership to these funds to "(v) *former members of a pension fund or provident fund who have elected to have a lump sum benefit contemplated in paragraph 2 (1) (c) of the Second Schedule transferred to this pension [provident] preservation fund and who made the election while they were members of that other fund*" ;

- the definition of "*pension fund*" has been amended to read as follows:

  ***"'(dd) that not more than one-third of the total value of the retirement interest may be commuted for a single payment, and that the remainder must be paid in the form of an annuity (including a living annuity) except where two-thirds of the total value does not exceed R165 000, where the employee is deceased or where the employee elects to transfer the retirement interest to a pension preservation fund or a retirement annuity fund;*"

*(**commenced on 1 January 2019 and applies in respect of years of assessment commencing on or after that date*)

- the definition of "*provident fund*" has been amended to require the rules of the fund to "*contain provisions similar in all respects to those required to be contained in the rules of a pension fund in terms of subparagraphs (aa), (bb), (cc), (ee) and (ff) of paragraph (ii) of the proviso to paragraph (c) in the definition of 'pension fund';* and now includes that the fund *"may provide for the employee to elect to transfer the retirement interest to a pension preservation fund, provident preservation fund or retirement annuity fund;*"

- the definition of "*retirement interest*" to include transfers to pension preservation fund, provident preservation fund:

''retirement interest' means a member's share of the value of a pension fund, pension preservation fund, provident fund, provident preservation fund or retirement annuity fund as determined in terms of the rules of the fund on the date on which he or she elects to retire or transfer to a pension preservation fund, provident preservation fund or retirement annuity fund;''.

The caveat

Please take note that the “once off withdrawal” option applicable to preservation funds before retirement date will not apply to *amounts transferred after reaching normal retirement age*. The “*pension preservation fund*” and “*provident preservation fund*” definitions as amended now include the following (new) carve out:

“(iii) a member who has transferred a retirement interest in terms of paragraph 2(1)(c) of the Second Schedule to this fund shall not be entitled to payment of a withdrawal benefit as contemplated in paragraph 2(1)(b)(ii) in respect of that transferred amount except to the extent that it is an amount contemplated in subparagraph (ii); and;”;

Conclusion

The bulk of these amendments will come into operation on 1 March 2019 and apply in respect of years of assessment commencing on or after that date (*please note I have indicated above the instances where other commencement dates apply). Funds will have to ensure that they align their fund rules timeously in order to comply with these changes by the March deadline.

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