Legal update 1 of 2023: Taxation Laws Amendment Act No. 20 of 2022

A. Summary

The Taxation Laws Amendment Act No. 20 of 2022 (the Amendment Act) was promulgated in Government Gazette No. 47826 on 5 January 2023.

The following changes are relevant for the retirement fund industry:

- Allowing a partial transfer on a retirement annuity fund.
- Protecting the vested benefits of a person who was a member of a provident fund on 1 March 2021 if that member transfers his benefit to a public sector fund.
- Allowing a member of a provident fund to retire before age 55.
- Allowing for the transfer of an in-fund living annuity to another fund.
- Correcting anomalies with regards to tax-neutral transfers.
- Clarifying that death benefits payable by a fund can be paid to an unclaimed benefit fund where there are no beneficiaries or an estate.

These amendments are discussed in more detail below.

B. Partial transfer on a retirement annuity fund

Background: The annuitisation alignment across all retirement funds, which came into effect on 1 March 2021, resulted in the tax-free transfers between the following funds:

From	To
Pension fund, pension preservation fund, provident fund, provident preservation fund	Pension fund, pension preservation fund, provident fund, provident preservation fund, retirement annuity fund
Retirement annuity fund	Retirement annuity fund

Paragraph (b)(xii) of the definition of 'retirement annuity fund' in section 1(1) of the Income Tax Act allows a member of a retirement annuity fund to transfer his ***total** interest in any approved retirement annuity fund into another approved retirement annuity fund*. The implication of this is that a member with more than one contract (policy) in the same retirement annuity fund may not do a split-transfer. If, for instance, he has two contracts in a retirement annuity fund, he may not transfer only one of those two contracts to another retirement annuity fund – it is all or nothing. This creates a problem where a member has taken out more than one contract in a specific retirement annuity fund, usually over a number of years, and only wants to transfer some of those contracts to another retirement annuity fund. The member may not want the rest of his contracts transferred, for various reasons, for instance the fact that one of those contracts is subject to the *grandfathering provision under Regulation 8(3)(c) of the Pension Funds Act which will be lost if it is transferred to another retirement annuity fund, or the contract is subject to causal event (termination) charges.

**Before 1 April 2011, the limits set out in Regulation 28 applied on fund-level, not on member-level. This allowed an individual member to breach the Regulation 28 limits as long as the fund itself (in other words the investments of all the members combined) complied with the Regulation 28 limits. Regulation 28(3)(c) allows for the investments of individual members of retirement annuity funds and pension and provident preservation funds in individual fund member policies entered into before 1 April 2011 to be exempt from the member-level compliance with the Regulation 28 limits as long as there are no transactional changes made to those investments. Such changes, which include changes to the frequency or quantum of contributions, additional contributions or portfolio switches would automatically trigger immediate member-level Regulation 28 limits*.

Preservation funds do not have the same all-or-nothing restriction. Paragraph (c) of the definitions of 'pension preservation fund' and 'provident preservation fund' in section 1(1) of the Income Tax Act allows for multiple transfers into and multiple part transfers out of a preservation fund.

Amendment: Paragraph (b)(xii) of the definition of 'retirement annuity fund' in section 1(1) of the Income Tax Act has been amended to allow a member to transfer individual contracts from a retirement annuity fund to another retirement annuity fund, subject to a *de minimis* amount of R371 250 (one and a half times the annuitisation *de minimis* of R247 500) applying to each individual contract transferred as well as the remaining balance in the transferring retirement annuity fund. It also makes it clear that this monetary restriction does not apply where the member transfers his total interest from one retirement annuity fund to another.

Effective date: 1 March 2023.

Practical implication: If a member has more than one contract in a retirement annuity fund, he may transfer one or more of those contracts to another retirement annuity fund, provided that the value of each individual contract transferred is more than the *de minimis* amount of R371 250 and the combined value of the remaining contracts is also more than R371 250. The transferring fund must complete a separate tax directive application for each transfer.

A member is not allowed to transfer a part of an individual contract to another retirement annuity fund. If he for instance has two contracts, contract 1 with a value of R1 200 000 and contract 2 valued at R800 000, he cannot transfer only R600 000 of contract 1 to another retirement annuity fund; he will have to transfer the entire R1 200 000 of contract 1 or the R800 000 in contract 2 to another retirement annuity fund.

If the member transfers all his contracts from one retirement annuity fund to another, the value of the individual contracts is irrelevant – no *de minimis* applies then.

Example: Peter has three contracts in a retirement annuity fund, with the following values as at 1 April 2023:

Contract A – R350 000

Contract B – R400 000

Contract C – R200 000

Options available to Peter:

Contracts transferred	Total value transferred	Contracts remaining	Total value remaining	Allowed?
A	R350 000	B and C	R600 000	✗
B	R400 000	A and C	R550 000	✓
C	R200 000	A and B	R750 000	✗
A and B	R350 000 + R400 000	C	R200 000	✗
A and C	R350 000 + R200 000	B	R400 000	✗
B and C	R400 000 + R200 000	A	R350 000	✗
A, B and C	Irrelevant	None	R0	✓

Important note

The *de minimis* introduced above ONLY applies to transfers between retirement annuity funds and should not be confused with the other *de minimis* amounts applying to retirement funds. The different *de minimis* amounts are now:

Event	***De minimis* amount**	**Implication**
Transfers between retirement annuity funds	R371 250	The value of each contract transferred must exceed R371 250 and the value of all the remaining contracts must also exceed R371 250.
Retirement annuity fund paid-up withdrawal	R 15 000	If the total value of the member's paid-up benefit is less than R15 000, he can withdraw his benefit as a lump sum before age 55.
Retirement benefit commutation	R247 500	If the total retirement benefit of a member of a retirement fund is less than R247 500, he can take the full retirement benefit as a lump sum.
Living annuity withdrawal/commutation	R125 000	If the remaining value on a living annuity policy is less than R125 000, the annuitant can take that as a lump sum.

C. Protection of vested benefit right on transfer to a public sector fund

Background: The annuitisation of provident funds and provident preservation funds became effective on 1 March 2021. Refer to paragraph 1 of *Legal Update 3 of 2021: Taxation Laws Amendment Act No. 23 of 2020* for more information on the implications of the annuitisation alignment across retirement funds.

All contributions to a provident fund pre-1 March 2021 and the value of the benefit in a provident preservation fund relating to pre-1 March 2021 transfers, including any growth thereon (known as the member's vested benefit), are protected and can still be taken as a lump sum. The benefit built up with contributions after 1 March 2021, plus the growth thereon, constitutes the member's non-vested benefit, which is subject to annuitisation. The vested benefit of a person who was a member of a provident fund on 1 March 2021 and who was 55 years or older on that date includes all the contributions made to the provident fund while the member remains in that same provident fund and the growth thereon. If that member transfers and contributes to a pension or provident fund, the benefit built up with the contributions after the transfer date, plus the growth thereon, constitutes the member's non-vested benefit, which is subject to annuitisation.

These vested benefits remain protected irrespective of the number of times the member transfers to another retirement fund, with one exception: if a member of a provident fund transfers his benefits to a public sector fund after 1 March 2021, he will lose the protection of his vested benefits and it will become subject to annuitisation. This is not aligned with the policy intention of the retirement fund reforms changes.

Amendment: The definitions of 'pension fund' and 'provident fund' in section 1(1) of the Income Tax Act have been amended by adding a proviso that makes it clear that the vested benefits of provident fund and provident preservation fund members who transfer their benefits to a public sector fund will also remain protected.

Effective date: 1 March 2023.

Practical implication: A member who transferred his vested benefit to a public sector fund between 1 March 2021 and 1 March 2023 would already have lost his vested benefit protection. His total benefit in the public sector fund would be regarded as a non-vested benefit, which would be subject to annuitisation. He would therefore have to use at least two-thirds of his retirement benefit to purchase an annuity, unless his total retirement benefit is less than the *de minimis*, currently R247 500.

The vested benefit of a member who transferred his benefit to a public sector fund on or after 1 March 2023 will retain its status as a vested benefit in the public sector fund. Refer to paragraph J of *Legal Update 2 of 2023: Public sector fund* benefits for a detailed explanation of this change as it relates to public sector funds.

Important note

When a member wishes to transfer a vested benefit to another fund, it is important that the member first finds out whether the new fund will and can accept that vested benefit. Not all funds' administration systems are able to accommodate the split between vested and non-vested benefits.

D. Retirement of a provident fund member on grounds other than ill-health before age 55

Background: Following the annuitisation alignment that came into effect from 1 March 2021, all retirement fund members must use at least two-thirds of their retirement benefits to purchase an annuity, subject to the **de minimis* rule and the protection of provident and provident preservation fund members' rights to take their vested benefits as a lump sum. Refer to paragraph 1 of *Legal Update 3 of 2021: Taxation Laws Amendment Act No. 23 of 2020* for more information on the implications of the annuitisation alignment across retirement funds.

> **If the total retirement benefit or the total non-vested benefit applying to provident and provident preservation fund members is less than R247 500, the member does not have to annuitise. He can then take the total retirement benefit as a lump sum.*

There is no minimum prescribed retirement age for pension or provident funds. The retirement date in these funds is the same as the retirement date imposed by the member's employer participating in the fund. In general, most of these funds' rules allow for a normal retirement age ranging between 60 and 65 years and early retirement from age 55. The earliest date on which a member of a preservation and retirement annuity fund can claim a retirement benefit from the fund is 55. There are, however, instances where an employer sets a lower normal retirement age for its employees linked to the nature of their occupation. An example of this is a pension or provident fund set up for rugby players, whose retirement age is around 35.

Paragraph 4(3) of the Second Schedule to the Income Tax Act currently requires the lump sum received by a member of a provident fund who retires from that fund before the age of 55 on grounds other than ill-health to be taxed as a withdrawal benefit. If that person was a member of a pension fund and he retired before age 55, his lump sum retirement benefit would have been taxed as a retirement benefit. This differentiation in the tax treatment of retirement benefit lump sums is not justifiable in light of the alignment of pension and provident funds which resulted in the contributions and retirement benefits of members of these two funds being treated in the same manner.

Amendment: Paragraph 4(3) of the Second Schedule to the Income Tax Act is deleted.

Effective date: 1 March 2023.

Practical implication: If a provident fund's rules allow for a retirement date earlier than 55, the lump sum retirement benefit of a member of that fund will be taxed as a retirement benefit.

Important note

Each fund has the right to determine its own retirement date. If the fund's rules do not allow for early retirement before 55, the member will not be able to retire from that fund before he reaches the age of 55, but instead will only be able to do a withdrawal.

E. Transfer of in-fund living annuity to another fund

Background: The current definition of 'living annuity' in section 1(1) of the Income Tax Act allows for an annuity to be purchased or provided by the fund of which the annuitant was a member on his retirement date. This can be interpreted to mean that an in-fund living annuity cannot be transferred to another fund. Although this is not an issue for retirement annuity and preservation funds, a narrow interpretation could have an adverse effect on pension and provident funds wanting to transfer all or part of their assets and liabilities to another pension or provident fund. For example, a participating employer in a free-standing retirement fund with in-fund living annuitants may wish to transfer to an umbrella fund under section 14 of the Pension funds Act. To enable the termination of the free-standing fund, the assets and liabilities of all its members (active and paid-up) and annuitants (retirees and death benefit beneficiaries) should be transferred to the umbrella fund. If a living annuity may only be provided by the fund of which the annuitant was a member, or former member in the case of a death benefit beneficiary, the freestanding fund would not be able to transfer the in-fund living annuities to the umbrella fund and the fund would have to remain open until it has met its liabilities in respect of the last of those annuitants. Such a position would effectively prevent the employer from moving to an umbrella fund, which stands in the way of consolidation.

Amendment: The Amendment Act substitutes the reference to 'that fund' in the definition of 'living annuity' in section 1(1) of the Income Tax Act with 'any fund'. The Explanatory Memorandum to the Amendment Act explains the rationale behind this change as 'a technical amendment that seeks to clarify that a living annuity can still be provided in instances where the fund providing the living annuity is not the same fund the individual was a member of on date of retirement'.

Effective date: No effective date has been specified, but since this amendment clarifies a specific issue rather than changing it, it will apply to living annuities that have already been transferred as well.

Practical implication: Where a participating employer transfers from one pension or provident fund to another pension or provident fund, or where one pension fund or provident fund is transferred to another pension or provident fund in toto, the transferring fund will be able to transfer their in-fund living annuities to the receiving fund.

F. Tax-neutral transfers between retirement funds

Background: The Income Tax Act allows transfers between similar types of retirement funds or from a less restrictive to a more restrictive retirement fund. Before annuitisation, a pension fund was more restrictive than a provident fund, because the provident fund allowed a member to take his whole retirement benefit as a lump sum, while a pension fund restricted the lump sum to a third of the total retirement benefit. A retirement annuity fund was and still is the most restrictive retirement fund. In addition to the one-third restriction on the retirement lump sum, a member of a retirement annuity fund is only allowed access to his benefit before he reaches the age of 55 under very specific circumstances. A retirement annuity fund benefit can therefore only be transferred to another retirement annuity fund. Refer to *Legal update 8 of 2021: Access to retirement annuity and preservation fund benefits* for more information regarding this.

The implementation of annuitisation across all retirement funds placed pension, pension preservation, provident and provident preservation funds on the same restriction level from 1 March 2021. Paragraph 6(1)(a)(i) of the Second Schedule to the Income Tax Act was therefore amended with effect from 1 March 2021 to provide for tax-neutral transfers as set out below:

From	To
Pension fund, pension preservation fund, provident fund, provident preservation fund	Pension fund, pension preservation fund, provident fund, provident preservation fund, retirement annuity fund
Retirement annuity fund	Retirement annuity fund

There is a misalignment between the definitions of 'provident preservation fund' in section 1(1) of the Income Tax Act and paragraph 6(1)(a)(i) of the Second Schedule to the Income Tax Act on the one hand and the definition of 'pension preservation fund' in section 1(1) of the Income Tax Act on the other hand. The first two allow for the transfer from a pension preservation fund to a provident preservation fund while the latter does not. This was an oversight.

The effective date for the change to paragraph 6(1)(a)(i) of the Second Schedule to the Income Tax Act was stated as follows: '1 March 2021 and applies in respect of contributions made on or after that date'. This had the unintended consequence of limiting the tax-neutral transfers only to that part of the transfer benefit relating to contributions made to the transferring fund from 1 March 2021.

Amendment: The Amendment Act corrects the two anomalies by including the reference to 'provident preservation fund' in the introductory paragraph of paragraph (c) of the definition of 'pension preservation fund' in section 1(1) of the Income Tax Act and by substituting the reference to 'contributions' in the paragraph dealing with the effective date of the change to paragraph 6(1)(a) of the Second Schedule to the Income Tax Act with 'transfers'.

Effective date: 1 March 2021.

Practical implication: Both amendments are technical corrections. In reality, SARS did not tax a transfer of a benefit from a pension preservation fund to a provident preservation fund, nor did they tax those portions of transfer benefits relating to contributions made before 1 March 2021.

G. Payment of death benefit to an unclaimed benefit fund where there is no beneficiary or estate

Background: Section 37C(1)(c) of the Pension Funds Act provides that if a fund does not become aware of or cannot trace any dependant of a deceased member within 12 months of the death of the member and the member has not nominated a beneficiary to receive a portion of the benefit in writing to the fund, the benefit or the remaining portion thereof - if there was a nominated beneficiary for a portion of the benefit - must be paid into the estate of the member. If the Master has not received an inventory (in other words, there is no estate), the benefit or the balance thereof if applicable (referred to hereinafter as an unallocated death benefit), must be paid into either the Guardian's Fund or an unclaimed benefit fund. This applies to all retirement funds except beneficiary funds, which are specifically dealt with under section 37C(3).

An unclaimed benefit fund is a preservation fund that is specifically created to accept unclaimed benefits as defined in the Pension Funds Act from retirement funds. This type of preservation fund is referred to in paragraph (a)(vi) of the definitions of 'pension preservation fund' and 'provident preservation fund' in section 1 (1) of the Income Tax Act.

The definition of 'unclaimed benefit' in section 1(1) of the Pension Funds Act does not specifically refer to an unallocated death benefit; it only refers to a benefit that became payable to a beneficiary but was then not paid within 24 months after the fund became aware of the member's death. This implies that the fund did find a beneficiary, allocated a portion of the death benefit to that beneficiary, but then did not pay it within the 24 months.

As stated in paragraph F of this legal update, a benefit from a retirement annuity fund can only be transferred to another retirement annuity fund. Although the Pension Funds Act allows for an unallocated death benefit to be transferred to an unclaimed benefit fund, this is not allowed for in the Income Tax Act.

Amendment: The Amendment Act amends paragraph (a)(vi) of the definitions of 'pension preservation fund' and 'provident preservation fund' in section 1 (1) of the Income Tax Act by substituting ''unclaimed benefit' as defined in the Pension Funds Act' with ''unclaimed benefit' as defined in section 1 of the Pension Funds Act and as contemplated in section 37C(1)(c) of the said Act'.

Effective date: No effective date has been specified as this is perceived to be a technical correction. In practice, unallocated death benefits are being transferred to unclaimed benefit funds.

Practical implication: The clarification aligns the legislation with industry practice.

The Income Act still does not allow for the transfer of an unallocated death benefit from a retirement annuity fund to an unclaimed benefit fund. It also does not allow for the transfer of an unclaimed benefit as defined in the Pension Funds Act from a retirement annuity fund or a beneficiary fund to an unclaimed benefit fund.

Hettie Joubert
Head: Legal - Wealth & Retirement Products
Momentum Investments