Legal update 2 of 2023: Public sector fund benefits

A. Summary

This document replaces Legal update 4 of 2020.

It describes what public sector funds are and how the benefits from these funds are taxed.

- Paragraph B explains what a public sector fund is.
- Paragraph C gives more information on the Government Employees Pension Fund.
- Paragraph D sets out the history of the taxation of public sector funds.
- Paragraph E describes how formula C/paragraph 2A of the Second Schedule to the Income Tax Act should be applied, emphasising that it only applies to the lump sum part of the benefit.
- Paragraph F clarifies why the tax-free benefit is not carried over to a compulsory annuity.
- Paragraph G deals with the calculation of the tax-free portion on transfer, confirming that the 'transfer' of the tax-free deduction under the formula only applies to the first and second transfers out of the public sector fund and not to the third transfer.
- Paragraph H explores various options available to a public sector fund member.
- Paragraph I explains how the formula C deduction affects a divorce order.
- Paragraph J provides the answer to whether a transferred benefit from a public sector fund should be seen as a vested or a non-vested benefit.
- Paragraph K emphasises the final points to keep in mind when dealing with public sector funds.

B. What is a public sector fund?

When formula C was removed from the Second Schedule of the Income Tax Act from March 2012 (read more about this in paragraph D of this document), a definition for 'public sector fund' was inserted. That definition read as follows:

*'"**public sector fund**" means a fund referred to in paragraph (a) or (b) of the definition of "pension fund" in section 1;'*,

that is a fund established by law, a municipal fund and funds for employees of the Marketing of Agricultural Products control board and employees of the Development Bank of Southern Africa.

From 1 March 2018, that definition also included paragraph (b) or (c) provident funds. From 1 March 2021, a public sector fund is defined as '*a fund referred to in paragraph (a), (b) or (d) of the definition of "pension fund" or paragraph (a), (b) or (c) of the definition of "provident fund" in section 1(1)*'.

From 1 March 2021, the definition of 'pension fund' in section 1(1) of the Income Tax Act lists the following funds under paragraphs (a), (b) and (d):

(a)(i) a pension fund established by law, other than the Government Employees Pension Fund;

(a)(ii) municipal funds;

(a)(iii) funds for employees of municipal entity funds created under the Municipal Systems Act;

(b) funds for employees of the Marketing of Agricultural Products control board and employees of the Development Bank of Southern Africa, and

(d) Government Employees Pension Fund.

The definition of 'provident fund' in section 1(1) of the Income Tax Act in turn refers to the following funds under paragraphs (a), (b) and (c):

(a) a provident fund established by law;

(b municipal funds; and

(c) funds for employees of municipal entity funds created under the Municipal Systems Act.

The following funds were established by law:

Name of Fund	**Name of statute in terms of which it was established**
Associated Institutions Pension Fund	Associated Institutions Pension Fund Act, 1963
Associated Institutions Provident Fund	Associated Institutions Provident Fund Act, 1971
Closed Pension Fund	Closed Pension Fund Act, 1993
Government Employees Pension Fund	Government Employees Pension Law, 1996
Members of Statutory Bodies Pension Scheme	Members of Statutory Bodies Pension Act, 1969
Post Office Retirement Fund	Post and Telecommunication-related Matters Act, 1958
SA Public Library Provident Fund	South African Public Library (Pensions and Provident Fund) Act, 1924
Temporary Employees Pension Fund	Temporary Employees Pension Fund Act, 1981
Telkom Pension Fund	Post and Telecommunication-related Matters Act, 1958
Transnet Retirement Fund	Transnet Pension Funds Act, 1990
Transnet Second Defined Benefit Fund	Transnet Pension Funds Act, 1990
Transport Pension Fund (formerly known as the Transnet Pension Fund)	Transnet Pension Funds Act, 1990

Although funds established by law (paragraph (a) of the definitions of 'pension fund' and 'provident fund') and the GEPF (paragraph (d) of the definitions of 'pension fund') currently do not have to be registered under the Pension Funds Act, all other types of pension funds and provident funds must be and are registered under the Pension Funds Act.

A search for normal active funds with the words 'Municipal', 'Munisipale', 'Local Authority/ies' and 'City Council' in their title and other known municipal funds on the FSCA's list of registered (active) funds showed the following municipal funds listed as pension and provident funds:

Pension funds	
Fund name	**FSCA reg. no.**
Alexandra City Council Pension Fund	12/8/00021824
Cape Municipal Pension Fund	12/8/00000909
City Of Johannesburg Pension Fund	12/8/00003722
(The) Consolidated Retirement Fund for Local Government	12/8/00032689
Durban Pension Fund	12/8/00032435
Eastern Cape Group Municipal Pension Fund	12/8/00033636
EJoburg Retirement Fund	12/8/00036961
Germiston Municipal Retirement Fund	12/8/00000382
Joint Municipal Pension Fund	12/8/00000318
Krugersdorp Munisipale Pensioenfonds	12/8/00000345
KwaZulu-Natal Joint Municipal Pension Fund (Retirement)	12/8/00006676
KwaZulu-Natal Joint Municipal Pension Fund (Superannuation)	12/8/00000553
KZN Municipal Pension Fund	12/8/00036983
Mafikeng City Council Pension Fund	12/8/00033929
MEU Retirement Fund	12/8/00037625
Municipal Employees Pension Fund	12/8/00005625
Municipal Gratuity Fund	12/8/00029256
Municipal Workers' Pension Fund	12/8/00034353
Municipal Workers' Retirement Fund	12/8/00031796
Oudtshoorn Munisipale Pensioenfonds	12/8/00017687
Phumula Retirement Fund	12/8/00000390
Phuthaditjhaba Municipality Umbrella Pension Fund	12/8/00030362
Potchefstroom Munisipale Aftreefonds	12/8/00002282
South African Local Authorities Pension Fund	12/8/00019727
(The) Soweto City Council Pension Fund	12/8/00021131
Tshwane Municipal Pension Fund	12/8/00000327
Vrystaat Munisipale Pensioenfonds	12/8/00000412

The Income Tax Act does not require that the rules of paragraph (a), (b) and (d) pension funds limit a member's lump sum retirement benefit to one-third of his retirement benefit. If the fund rules allow for it, a member of such a fund may take more than one-third of his retirement benefit in a lump sum; he may even take his whole retirement benefit in a lump sum, similar to a provident fund, if the fund rules allow for it. Such a pension fund will then be classified as a 'provident fund' as defined in the Second Schedule to the Income Tax Act.

To date, the Income Tax Act has not been amended to require these pension funds to annuitise on retirement; that is to limit the lump sum that can be taken to a maximum of one-third of the retirement benefit, unless the total retirement benefit is less than the legislated *de minimis* amount – currently R247 500.

Provident funds	
Fund name	**FSCA reg. no.**
Eastern Cape Group Municipal Gratuity Fund	12/8/00037086
Eastern Cape Local Authorities Provident Fund	12/8/00030761
Free State Municipal Provident Fund	12/8/00031488

KwaZulu-Natal Joint Municipal Provident Fund	12/8/00032588
Local Authority Multi Provident Fund	12/8/00030718
National Fund for Municipal Workers	12/8/00035064
Phuthaditjhaba Municipality Umbrella Provident Fund	12/8/00031741
South African Local Authorities Provident Fund	12/8/00020184
Tshwane Municipal Provident Fund	12/8/00001535
Umtata Municipality Provident Fund	12/8/00036761

Important note

Not all public sector funds' rules allow their members to take more than one-third of the retirement benefit as a lump sum. If in doubt, the fund rules should be consulted to see if it is indeed allowed.

C. Government Employees Pension Fund (GEPF)

The GEPF is included under paragraph (d) of the definition of 'pension fund' in section 1 of the Income Tax Act.

The rules of the GEPF (contained in the Government Employees Pension Law) provide that if the member has less than 10 years' service at retirement, he can take his whole retirement benefit in a lump sum. If he has more than 10 years' service, he becomes entitled to a once-off lump sum, called a gratuity, and a monthly pension, which is paid for the lifetime of the pensioner. The member does not have the option to transfer the retirement benefit to a compulsory life annuity/living annuity.

Rule 14.4.1(b) of the rules of the GEPF, read together with the definition of 'approved retirement fund' in the Government Employees Pension Law, allows for the transfer of a resignation benefit to a fund which has been registered as a pension fund organisation in terms of the Pension Funds Act and approved as a pension fund, retirement annuity fund and provident fund in terms of the Income Tax Act. Rule 12.3 suggests that this includes transfers to preservation funds.

Before 1 March 2006, the transfer benefit from the GEPF consisted of two components: the resignation benefit component and the actuarial component. The resignation benefit was taxed as explained under paragraph D below and was then transferred (post tax) along with the actuarial benefit to an approved retirement fund.

Transfers from the GEPF are usually done to a pension preservation fund or a retirement annuity fund, which means that on retirement, the one-third restriction will apply.

D. Taxation of public sector fund benefits

Before 1 March 1998, the lump sum benefits paid from public sector funds were not taxable. The Income Tax Act No. 28 of 1997 introduced tax on public sector funds from 1 March 1998. All benefits accrued in the public sector fund prior to 1 March 1998 would remain tax-free (commonly referred to as 'pre-1998 vested rights') and all benefits built up from 1 March 1998 onwards would be subject to tax. To determine the taxable portion of a member's lump sum benefit, formula C was introduced in the Second Schedule to the Income Tax Act from 1 March 1998. The Second Schedule deals with the computation of gross income derived by way of lump sum benefits. The formula was moved to paragraph 2A of the Second Schedule under the Taxation Laws Amendment Act No. 22 of 2012 from 1 March 2012.

Paragraph 2A, read together with paragraphs 2(1) and 2C, sets out what part of a public sector fund member's lump sum retirement benefit must be included in a member's 'gross income' as defined in section 1 of the Income Tax Act. Amounts included will form part of the member's taxable income and will then be taxed either on the table applying to a retirement fund lump sum withdrawal benefit (withdrawal tax table) or a retirement fund lump sum benefit (retirement tax table), depending on the mode of exit from the fund.

Paragraphs 5 and 6 of the Second Schedule set out what amounts should be deducted from lump sum benefits before the tax tables are applied. Paragraph 5 applies to retirement benefits, while paragraph 6 applies to withdrawal benefits.

Section 52 of the Taxation Laws Amendment Act No. 8 of 2007 amended paragraph 6 of the Second Schedule to provide that the tax-free amount calculated under the old Formula C would be allowed as a deduction before the tax on a **withdrawal** benefit is calculated, if a benefit has been transferred from a public sector fund to a pension fund, provident fund, or retirement annuity fund. That amendment came into operation on 1 March 2006 and applied to a lump sum benefit received or accrued on or after that date. The implication of that amendment was that the deduction would only apply to transfers from 1 March 2006.

Section 62 of the Taxation Laws Amendment Act No. 17 of 2009 expanded these deductions to apply to transfers to 'such funds'. Section 84 of the Taxation Laws Amendment Act No. 7 of 2010 changed 'such funds' to 'a pension fund, pension preservation fund, provident fund, provident preservation fund or retirement annuity fund'. The amendment came into operation on 1 March 2009 and applied to a lump sum benefit received or accrued on or after that date, which means that it applied to benefits transferred on or after 1 March 2009.

Section 61 of the Taxation Laws Amendment Act No. 17 of 2009 amended paragraph 5 of the Second Schedule to provide that the tax-free amount calculated under the old Formula C would be allowed as a deduction before the tax on a **retirement** benefit is calculated, if a benefit has been transferred from a public sector fund to a pension fund, pension preservation fund, provident fund, provident preservation fund or retirement annuity fund. That amendment came into operation on 1 March 2009 and applied to a lump sum benefit received or accrued on or after that date. The result of that amendment was that the deduction would only apply to transfers from 1 March 2009 and only on the first transfer from the public sector fund.

The Taxation Laws Amendment Act No. 17 of 2017 changed paragraphs (5) and (6) to allow for the deduction to apply on one additional transfer. This meant that if a member in a public sector fund transferred to a pension fund after 1 March 2009 and now transferred to another pension fund after 1 March 2018, he would be entitled to the deduction of the tax-free amount determined under the formula in paragraph 2A of the Second Schedule.

A summary of the history explained above:

Amendment Act	Change	Effective date
ITA No. 28 of 1997	Public sector fund benefits accrued in the fund from 1 March 1998 onwards are taxed.	1 March 1998
TLAA No. 8 of 2007	Tax-free benefit carried forward to first transfer to pension fund, provident fund or retirement annuity fund qualifies as deduction on withdrawal (paragraph 6).	1 March 2006
TLAA No. 17 of 2009 & 7 of 2010	Tax-free benefit carried forward to first transfer to pension fund, pension preservation fund, provident fund, provident preservation fund or retirement annuity fund qualifies as deduction on retirement (paragraph 5) and withdrawal (paragraph 6).	1 March 2009
TLAA No. 17 of 2017	Tax-free benefit carried forward to second transfer to pension fund, pension preservation fund, provident fund, provident preservation fund or retirement annuity fund qualifies as deduction on retirement and withdrawal.	1 March 2018

E. Applying Formula C/Paragraph 2A of the Second Schedule to the Income Tax Act in a public sector fund

To determine which portion of the benefit in the public sector fund will be taxed, one must use a formula. As stated in the previous paragraph, this formula was defined as formula C in the Second Schedule to the Income Tax Act before the definition was deleted and the formula moved to paragraph 2A. The formula itself did not change.
In short, the formula is:

$$\mathbf{A = \frac{B}{C} \times D}$$

Where:

A = taxable amount to be determined

B = *completed years of employment/service after 1 March 1998

C = total number of completed years of service

D = **lump sum benefit**

*Completed years of employment after 1 March 1998 or completed years of employment approved after 1 March 1998 during which the member had been a member of the public sector fund, including previous or other periods of service approved as pensionable service in terms of the rules of the public sector fund after 1 March 1998.

Important notes

a. The formula only applies to **lump sum** benefits payable to a member of a pension fund, pension preservation fund, provident fund, provident preservation fund or retirement annuity fund.

b. Only that part of a member's benefit that he takes in a **lump sum** should be used for A in the formula; not the member's **total** benefit.

c. On **resignation**, the formula is applied to that part of the benefit that is payable to the member, or if the total withdrawal benefit is transferred to another fund, to the total benefit.

   If a member takes a part of his resignation benefit in the public sector fund and transfers the balance to another fund, the formula will NOT be applied to the total resignation benefit; it will only be applied to that part of the resignation benefit that the member actually takes. This is because although the total benefit in the public sector fund *accrues* to the member as a lump sum on his resignation, only that part that he decides to take is *payable* to him. The formula does not apply to the lump sum benefit that *accrues* to the member, but rather to the lump sum *payable* to him – refer to the definition of 'D' in the formula. A member can therefore not apply the formula on the total resignation benefit, take less than the tax-free amount calculated under that formula, transfer the rest of the resignation benefit to another fund, and then claim the 'balance' of the tax-free portion calculated on the total resignation benefit that was not taken on resignation at a later stage when he exits the receiving fund; there is no 'balance' that was transferred to the receiving fund.

   SARS confirmed this as follows in a non-binding private opinion on 2 February 2021:

   *' The formula in paragraph 2A in the Second Schedule to the Income Tax Act No. 58 of 1962, as amended ('the Act'), relating to pre-1998 years of service in a public sector fund, is only applicable to lump sum benefits **payable** to a member of a pension fund, pension preservation fund, provident fund, provident preservation fund or retirement annuity fund by virtue of the symbol 'D' in the formula.*

   In circumstances where the pre-1998 years of service in a public sector fund were already taken into account on a lump sum benefit previously received, the pre-1998 vested rights cannot be taken into account again on a subsequent lump sum benefit payable.

....

It must be noted that Paragraph 5 of the Second Schedule to the Act specifically provides for a deduction in circumstances where the amount has not been allowed as a deduction to a member previously. Where members of public sector funds transfer the taxable portion of a benefit to another fund, and take the tax-free portion as a lump sum prior to transferring, it cannot be said that the taxable portion has not previously been allowed to the person as a deduction in terms of this Schedule. It is in fact the tax-free amount that was allowed as a deduction in terms of the Schedule under the provisions of Paragraph 6 of the Second Schedule to the Act.'

The only way to be able to apply the formula on the total resignation benefit, is to not take any part of that benefit as a lump sum in the public sector fund, but to transfer the total resignation benefit to another fund.

Example 1*:* Belinda joined a public sector fund on 1 March 1978 and resigned on 31 January 2023. Her resignation benefit is R6 600 000.

Benefit	R6 600 000
Start date	01/03/1978
End date	31/01/2023

Formula to calculate **taxable** amount

$$\mathbf{A = \frac{B}{C} \times D}$$

Where:

	=	Applied in this case	
A	taxable amount to be determined		
B	completed years of employment/service **after** 1/3/1998	01/03/1998 – 28/02/2022	24
C	**total** number of completed years of service	01/03/1978 – 31/01/2023	44
D	lump sum benefit		R6 600 000

$$A = \frac{24}{44} \times 6\,600\,000$$

$$= 3\,600\,000$$

Calculate pre-1 March 1998 **tax-free** amount:

Total lump sum benefit	– taxable amount calculated on the above formula	= tax-free amount
R6 600 000	– R3 600 000	= R3 000 000

If Belinda took her total resignation benefit of R6 600 000, she would have received the R3 000 000 pre-1 March 1998 benefit tax-free. In addition, she would also have been able to get another R25 000 taxed on the withdrawal tax table that applied on 31 January 2023 at 0%.

However, if Belinda decided to only take R3 000 000 as a lump sum and transfer the rest to a preservation fund, the formula would have been applied on R3 000 000, not R6 000 000. She would then have received R1 363 636 (pre-1 March 1998 tax-free benefit) plus R25 000 (taxed on the withdrawal rax table that applied on 31 January 2023 at 0%) without having to pay any tax. Because she took a withdrawal benefit prior to the transfer to the preservation fund and the pre-1998 tax-free benefit was already allowed as a deduction against that withdrawal benefit, the formula cannot be applied against the retirement fund lump sum benefit that she will be receiving when she retires from the preservation fund; that would have resulted in her receiving the tax relief on the same pre-1998 years of service again.

Note: If this was a retirement benefit instead of a resignation benefit and Belinda took the maximum lump sum allowed (one-third), the formula would have been applied to the R2 200 000 lump sum actually taken and not the full retirement benefit.

d. On the **death** of the member, the formula is applied to that part of the death benefit that is taken as a lump sum. It is taxed in the hands of the deceased member as if the deceased member received the benefit the day immediately before his death.

e. Some funds allow their members to buy **additional pensionable service years**. These years are usually only taken into account to compute the benefit itself and not necessarily included in 'B' of the formula.

   As far as the GEPF is concerned, paragraph 2A of the Second Schedule to the Income Tax Act states that *the years of pensionable service recognised as such in terms of Rule 10.5 or 10.6 of the Rules of the Government Employees Pension Fund* must be taken into consideration in the calculation of 'B' of the formula.

   Rule 10.5 deals with *a period during which a **member was not eligible for membership** of a previous fund or the Temporary Employees Pension Fund, where such period was, in the opinion of the Board, **discriminatory to members**.*

   Rule 10.6 relates to *a period of NSF service.* NSF Service is defined as follows:

   > '***NSF Service'****, the period between the date on which a former member of a non-statutory force or service joined his or her respective former forces or services (as reflected on his or her service certificate) and the date of their taking up employment, or entering into an agreement with or their attestation into the employer, provided that such service will only be recognised for the period after the former member of a non-statutory force or service attained the age of sixteen years, so that service prior to the age of sixteen years will not be regarded as NSF Service. In the case of a beneficiary of a former member of a non-statutory force or service, NSF Service means the period of NSF Service of the former member of a non-statutory force or service through whom the beneficiary is entitled to a benefit in terms of the Fund.*

   Neither of these two Rules allow purchased service to be taken into account in determining a member's pre-1998 tax-free benefit.

   SARS confirmed that if the fund rules do not specifically state that additional purchased service should be taken into account for determining the taxable / tax-free portion of a member's lump sum benefit, then it will not be taken into account for that purpose. If the rules are silent on this issue, the assumption is that it is not to be taken into account to determine 'B' of the formula.

f. Where there is a difference between the date on which a member's employment started and the date on which his fund membership started, the earliest of the two dates should be used as the start date for 'B' of the formula.

   Example 2: When John started working for a municipality in KwaZulu-Natal (KZN) on 1 February 1978, he became a member of a KZN municipal fund. On 1 July 2023, he started working at a municipality in Gauteng and became a member of a Gauteng municipal fund. He opted to have his benefit from the KZN municipal fund transferred to the Gauteng municipal fund.

   - ✓ The start date for determining 'B' when John retires from the Gauteng municipal fund will be 1 February 1978.

g. Where a member has left employment but has not yet taken his benefit from the public sector fund, the date that should be used as the **end date** to determine 'B' in the formula will depend on the fund rules. If the rules refer to the completed years of employment to be used to determine the benefit payable by the fund, then the date of the member leaving employment would be the end date.

h. Only **completed years** should be taken into account for 'B' and 'C' in the formula. Years should not be rounded off or pro-rated.

Example 3: A member's withdrawal date from the public sector fund is 31 January 2023.

- ✓ 'B' is equal to 24; not rounded to 25 or pro-rated to 24 years and 11 months.

i. The value of the lump sum benefit payable to the member represented by 'D' in the formula is determined by the provisions of the rules of that fund and not by the provisions of the Income Tax Act. For a GEPF member for instance, this will either be the member's resignation benefit or his actuarial value if the member is still in the GEPF, or if the member has been transferred to another fund, the amount recorded on the transfer form as 'Amount reflected on the tax directive application'.

Applying the formula
Calculation of tax-free amount and tax payable
Example 4:

Peter was a member of a public sector fund from 1 February 1986.

On 31 December 2023, he retires from the fund with a total benefit of R5 755 500.

The rules of the fund allow him to take his whole retirement benefit as a lump sum.

To determine the maximum tax-free amount, one must assume that the member takes his whole benefit in a lump sum.

Benefit	R5 755 500
Start date	01/02/1986
End date	31/12/2023

Formula to calculate **taxable** amount

$$\mathbf{A = \frac{B}{C} \times D}$$

Where:

	=	Applied in this case	
A	taxable amount to be determined		
B	completed years of employment/service **after** 1/3/1998	01/03/1998 – 28/02/2023	25
C	**total** number of completed years of service	01/02/1986 – 31/12/2023	37
D	lump sum benefit	R5 755 500	

$$A = \frac{25}{37} \times 5\ 755\ 500$$

= 3 888 851 (rounded to nearest rand)

Calculate pre-1 March 1998 **tax-free** amount:

Total lump sum benefit	– taxable amount calculated on the above formula	= tax-free amount
R5 755 500	– R3 888 851	= R1 866 649

An amount of R3 888 851 of Peter's total lump sum benefit of R5 755 500 will be subject to tax and he will get R1 866 649 tax-free. Assuming that he does not qualify for any other deductions under paragraph 5 of the Second

Schedule to the Income Tax Act and also did not receive any other benefits from a retirement fund, the retirement tax table will apply on the taxable lump sum benefit of R3 888 851 as follows (all figures rounded to nearest rand):

Taxable income from lump sum benefits	Rate of tax
0 – R550 000	0%
R550 001 – R770 000	18% of the amount above R550 000
R770 001 – R1 155 000	R39 600 + 27% of the amount above R770 000
R1 155 001 and above	R143 550 + 36% of the amount above R1 155 000

Tax = R143 550 + 36% of (R3 888 851 – R1 155 000)
= R143 550 + 36% of R2 733 851
= R143 550 + R984 186
= R1 127 736

Result:

Total lump sum	R5 755 500
Tax payable	R1 127 736
Nett lump sum, after tax	R4 627 764

Peter cannot decide to only take his tax-free portion of R1 866 649 as calculated under the formula as a lump sum. That would be doing the calculation in reverse.

Only that portion of the benefit taken as a lump sum will be subject to the formula.

If Peter decides to take R1 866 649 as a lump sum (following the previous calculation) and buy an annuity with the rest, then **only** the lump sum of R1 866 649 will be subject to the formula. The calculation will then have to be redone from scratch as follows:

$$A = \frac{25}{37} \times \text{R1 866 649}$$

= 1 261 249

Calculate pre-1 March 1998 **tax-free** amount:

Total lump sum benefit	– taxable amount calculated on the above formula	= tax-free amount
R1 866 649	– R1 261 249	= R605 400

In this case, R1 261 249 of Peter's total lump sum benefit of R1 866 649 will be subject to tax and he will only get the balance of R605 400 tax-free.

Assuming that Peter does not qualify for any other deductions under paragraph 5 of the Second Schedule to the Income Tax Act and he also did not receive any other benefits from a retirement fund, the retirement tax table will apply on the taxable lump sum benefit of R1 261 249 as follows:

Taxable income from lump sum benefits	Rate of tax
0 – R550 000	0%
R550 001 – R770 000	18% of the amount above R550 000
R770 001 – R1 155 000	R39 600 + 27% of the amount above R770 000
R1 155 001 and above	R143 550 + 36% of the amount above R1 155 000

Tax = R143 550 + 36% of (R1 261 249 – R1 155 000)
= R143 550 + 36% of R106 249
= R143 550 + R38 250
= R181 800

Result:

Total lump sum	R1 261 249
Tax payable	R181 800
Nett lump sum, after tax	R1 079 449

Peter will also have to pay tax on the annuity income that he bought with the balance of his benefit, which is R3 888 851 (R5 755 500 total benefit – R1 866 649 lump sum) as and when he receives an income from that annuity, at his marginal tax rate.

F. Is the tax-free benefit carried over to a compulsory annuity?

The short answer is no.

Section 10C(2) of the Income Tax Act (the Act) states the following:

'(2) There shall be exempt from normal tax in respect of the aggregate of compulsory annuities payable to a person ***an amount equal to so much of the person's own contributions*** *to any pension fund, provident fund and retirement annuity fund that did not rank for a deduction against the person's income in terms of section 11F as has not previously been —*

(a) allowed to the person as a deduction in terms of the Second Schedule; or

(b) exempted from normal tax in terms of this section,

in respect of any year of assessment.'

This means that the provision above can only be applied to the excess of own contributions which were not previously allowed as a deduction under section 11F of the Act or under paragraphs 5 and 6 of the Second Schedule to the Act and not to any other deductions referred to in paragraphs 5 and 6.

Paragraph 5(1)(e) of the Second Schedule to the Income Tax Act states the following:

'5. (1) The deduction to be allowed ***for the purposes of paragraph 2 (1) (a)*** *is an amount equal to so much of—*

(e) any other amounts in respect of which the formula in paragraph 2A applies, which have been –

(i) paid into a pension fund, pension preservation fund, provident fund, provident preservation fund or retirement annuity fund for the person's benefit by a public sector fund; and

(ii) transferred into a pension fund, pension preservation fund, provident fund, provident preservation fund or retirement annuity fund directly from a fund contemplated in sub item (i) for the person's benefit,

less the amount represented by symbol A when so applying that formula,

as has not been exempted in terms of section 10C or has not previously been allowed to the person as a deduction in terms of this Schedule in determining the amount to be included in that person's gross income.'

This only refers to amounts transferred from a public sector fund to another approved fund and not to contributions made by an individual to an approved pension fund or retirement annuity fund under section 11F of the Act.

Paragraph 2(1)(a) in turn provides as follows:

'2. (1) Subject to section 9 (2) (i) and paragraphs 2A, 2C and 2D, the amount to be included in the gross income of any person for any year of assessment in terms of paragraph (e) of the definition of "gross income" in section 1 shall be—

(a) any amount received by or accrued to that person by way of a lump sum benefit derived in consequence of or following upon—

*(i) his or her **retirement** or death;*

…….

*(iii) the **commutation of an annuity** or portion of an annuity,*

less any deduction permitted under the provisions of paragraph 5 *or* 6.*'*

In an email dated 14 July 2020, SARS stated as follows:

' We are in agreement with your view that the vested rights of the (now deceased) member is lost when the 3/3rd benefit was used to purchase an annuity. It is therefore not carried forward to the beneficiary upon the death of a former (now deceased) member.

Paragraph 2A of the Second Schedule to the Income Tax Act prescribes the formula to be applied on the lump sum benefit received or accrued from a public sector fund.

Paragraph 5(1)(e) of the Second Schedule provides for the following deduction against a member's lump sum retirement benefit:

………………….

The deceased member however, at retirement, opted to receive the entire benefit as an annuity and therefore the pre-vested 1998 rights fell away. It was only at this point that the member was entitled to utilise this benefit. This means that the paragraph 2A will not be allowable as a deduction upon the death of the annuitant should the beneficiary wish to take a lump sum benefit on the death of the member.

It should be further noted upon retirement one does not "transfer" in the true sense of the word when one opts to purchase a living annuity at retirement. The liability of the fund to pay the annuity is terminated and outsourced to an insurer, as such, to provide the living annuity.'

This confirms that the exemption provision under section 10C of the Act cannot be where the member uses the full retirement benefit payable by the fund to buy a compulsory annuity. If the member therefore does not take any part of his retirement benefit as a lump sum, and there is no other retirement fund benefit payable to him, he will forfeit the benefit of the pre-1 March 1998 tax-free benefit.

G. Calculation of tax-free portion on transfer

Paragraphs 5 and 6 of the Second Schedule to the Income Tax Act allow for the deduction of the tax-free amount determined under the formula from a public sector fund member's benefit that was

1. paid into a pension fund, pension preservation fund, provident fund, provident preservation fund or retirement annuity fund, and
2. transferred from the fund in 1 above into another pension fund, pension preservation fund, provident fund, provident preservation fund or retirement annuity fund.

When that member subsequently withdraws or retires from the receiving fund, he will be entitled to deduct that tax-free portion from his withdrawal/retirement benefit, in addition to all the other deductions allowed under paragraph 5 (for retirement benefits) or paragraph 6 (for withdrawal benefits). This deduction of the pre-March 1998 tax-free built-up only applies to **two** transfers from the public sector fund as set out in 1 and 2 above, and only if those two transfers happened within the timeframes referred to in paragraph D of this document.

Example 5: James transferred his benefit in a public sector fund to a pension fund in 2005. He lost the right to claim the deduction of the pre-1 March 1998 tax-free amount from his benefit when he leaves the pension fund because the 'transfer' of the tax-free portion to a pension fund was only allowed from 1 March 2006.

Example 6: Amelia transferred her benefit in a public sector fund to a pension fund in 2007 and then transferred her benefit in that pension fund to a pension preservation fund in 2017. Amelia lost the right to claim the deduction of the pre-1 March 1998 tax-free amount from her benefit when she leaves the pension preservation fund – the 'transfer' of the tax-free portion to a second fund was only allowed from 1 March 2018.

Example 7: Samantha transferred her benefit in a public sector fund to a pension fund in 2007, then transferred her benefit in that pension fund to a pension preservation fund in 2019. In 2022 she transferred her benefit from that pension preservation fund to a provident preservation fund. Samantha lost the right to claim the deduction of the pre-1 March 1998 tax-free amount from her benefit when she leaves the provident preservation fund as the transfer to the provident preservation fund was a third transfer and paragraphs 5 and 6 of the Second Schedule to the Income Tax Act only allows for two transfers.

The tax-free portion is calculated as follows by the transferring fund:

Lump sum transferred – amount determined under the formula = tax-free amount.

A retirement fund must apply for a tax directive, using Form B, when the member's benefit is transferred to another fund. When the public sector fund completes Form B, it must indicate that it is a public sector fund. If the member joined the public sector fund before 1 March 1998, the public sector fund must complete the blocks dealing with the start and end date of the member's employment. The SARS tax directive system will then use these dates to determine the completed years and apply the formula in paragraph 2A of the Second Schedule to the Income Tax Act. The tax directive will not trigger any tax payable; from 1 March 2021 all transfers from public sector funds to other funds are tax neutral. In the block under the heading *Exemptions and Deductions allowed in terms of the 2nd Schedule of the Act:* it will indicate the *Vested right pre-1 March 1998* – this is the tax-free benefit captured on the SARS system, which will automatically be deducted from the member's lump sum when he takes a withdrawal or retirement benefit from the receiving fund.

H. Options for public sector fund member

Joanne started working at a municipality and became a member of a municipal fund on 1 July 1980. On 31 March 2023, she will reach her normal retirement age. The rules of the municipal fund provide that a member must use at least two-thirds of their retirement benefit to purchase an annuity. Joanne is exploring the following options:

1. Take a retirement benefit from the municipal fund and take the maximum lump sum.
2. Transfer her retirement benefit from the municipal fund to a pension preservation fund, retire from that pension preservation fund on 31 May 2023 and take the maximum lump sum.
3. Resign from the municipality on 31 January 2023, transfer her withdrawal benefit from the municipal fund to a pension preservation fund and take a full pre-retirement withdrawal from that pension preservation fund on 31 May 2023.
4. Resign from the municipality on 31 January 2023, transfer her withdrawal benefit from the municipal fund to a pension preservation fund, take the pre-1 March 1998 tax-free benefit as a pre-retirement withdrawal immediately thereafter and retire from that pension preservation fund on 31 May 2023, taking the maximum lump sum.

5. Resign from the municipality on 31 January 2023, transfer her withdrawal benefit from the municipal fund to a pension preservation fund, take the pre-1 March 1998 tax-free benefit as a pre-retirement withdrawal immediately thereafter and retire from that pension preservation fund on 31 May 2023, taking only R500 000 as a lump sum.

Assumptions used:

- Benefit on 31 January 2023 = R8 721 000
- Benefit on 31 March 2023 = R8 721 240
- Benefit on 31 May 2023 = R8 721 540
- Joanne does not qualify for any other deductions under paragraph 5 of the Second Schedule to the Income Tax Act and also did not receive any other benefits from a retirement fund.
- All figures are rounded to the nearest rand.

Important notes

- Before advising a public sector fund member that they are allowed to transfer a pre-retirement benefit to another fund, make sure that the rules of the public sector fund allow for that. Some public sector funds, like the Transnet Retirement Fund deems a member to have retired if he withdraws within three years from normal retirement age. The impact of this is that a member of that who has reached the age of 60 is not entitled to a withdrawal benefit from the fund.
- Similarly, not all funds allow their members to transfer their retirement benefit to another fund. As an example, once the member reaches the normal retirement age in the GEPF, the member must take a retirement benefit from the GEPF. The member is not allowed to transfer that benefit to another fund.

Example 8: Retire on 31 March 2023 and take the maximum lump sum retirement benefit from the municipal fund

Total benefit	R8 721 240
Limited to 1/3rd	R2 907 080
Start date	01/07/1980
End date	31/03/2023

$$\mathbf{A = \frac{B}{C} \times D}$$

Where:

	=	Applied in this case	
A	taxable amount to be determined		
B	completed years of employment/service **after** 1/3/1998	01/03/1998 – 28/02/2023	25
C	**total** number of completed years of service	01/07/1980 – 31/03/2023	43
D	lump sum benefit		R2 907 080

$$A = \frac{25}{43} \times 2\ 907\ 080$$

$$= 1\ 690\ 163$$

Calculate pre-1 March 1998 **tax-free** amount:

Total lump sum benefit	– taxable amount calculated on the above formula	= tax-free amount
R2 907 080	– R1 690 163	= R1 216 917

The amount of R1 690 163 of the total lump sum benefit of R2 907 080 will be subject to tax and Joanne will only get the balance of R1 216 917 tax-free. The retirement tax table will apply to the taxable lump sum benefit of R1 690 163 as follows (rounded to nearest rand):

Taxable income from lump sum benefits	Rate of tax
0 – R550 000	0%
R550 001 – R770 000	18% of the amount above R550 000
R770 001 – R1 155 000	R39 600 + 27% of the amount above R770 000
R1 155 001 and above	R143 550 + 36% of the amount above R1 155 000

Tax = R143 550 + 36% of (R1 690 163 – R1 155 000)
= R143 550 + 36% of R535 163
= R143 550 + R192 659
= R336 209

Result:

Total lump sum	R2 907 080
Tax payable	R336 209
Nett lump sum, after tax	R3 243 289

Joanne will also have to pay tax on the annuity provided by the municipal fund as and when she receives an income from that annuity, at her marginal tax rate. The amount available to fund the annuity is R5 814 160. If the municipal fund is a defined benefit fund, the annuity will be calculated actuarially and provided for life.

Example 9: Transfer the retirement benefit from the municipal fund to a pension preservation fund, retire from that pension preservation fund on 31 May 2023 and take the maximum lump sum benefit

Total benefit	R8 721 540
Start date	01/07/1980
End date	31/05/2023

$$\mathbf{A} = \frac{\mathbf{B}}{\mathbf{C}} \times \mathbf{D}$$

Where:

	=	Applied in this case	
A	taxable amount to be determined		
B	completed years of employment/service **after** 1/3/1998	01/03/1998 – 28/02/2023	25
C	**total** number of completed years of service	01/07/1980 – 31/05/2023	43
D	lump sum benefit	R8 721 540	

$$A = \frac{25}{43} \times 8\ 721\ 240$$

= 5 070 663

Calculate pre-1 March 1998 **tax-free** amount:

Total lump sum benefit	– taxable amount calculated on the above formula	= tax-free amount
R8 721 540	– R5 070 663	= R3 650 877

The amount of R5 070 663 of the total lump sum benefit of R8 721 540 will be subject to tax.

The calculation shows a pre-1 March 1998 tax-free amount of R3 650 877. However, the benefit that Joanne transferred to the pension preservation fund was a 'post-retirement' benefit (a benefit transferred after having reached normal retirement age but before retirement date), resulting in Joanne not being entitled to make a pre-retirement withdrawal from the pension preservation fund. The only benefit that she is entitled to in that fund is a retirement benefit. When she does take a retirement benefit from the pension preservation fund on 31 May 2023, she may only take a maximum of one-third (R8 721 540 ÷ 3 = R2 907 180) as a lump sum benefit. Because the pre-1 March 1998 tax-free portion (R3 650 877) is more than the one-third that may be taken as a lump sum (R2 907 140), she can take the full one-third of R2 907 140 without paying any tax on it. She, however, loses out on the balance of the pre-1 March 1998 tax-free portion (R3 650 827 - R2 907 180 = R743 647). She will also not be entitled to use the R500 000 tax-free benefit on the retirement tax table, unless she retires from another fund where she will be able to take a lump sum of R500 000 or more.

Result:

Total lump sum	R2 907 180
Tax payable	R0
Nett lump sum, after tax	R2 907 180

Example 10: Resign from the municipality on 31 January 2023, transfer the withdrawal benefit from the municipal fund to a pension preservation fund and take a full pre-retirement withdrawal from that pension preservation fund on 31 May 2023.

Total benefit	R8 721 000
Start date	01/07/1980
End date	31/01/2023

$$\mathbf{A = \frac{B}{C} \times D}$$

Where:

	=	Applied in this case	
A	taxable amount to be determined		
B	completed years of employment/service **after** 1/3/1998	01/03/1998 – 28/02/2023	25
C	**total** number of completed years of service	01/07/1980 – 31/01/2023	43
D	lump sum benefit	R8 721 000	

$$A = \frac{25}{43} \times 8\ 721\ 000$$

$$= 5\ 070\ 349$$

Calculate pre-1 March 1998 **tax-free** amount:

Total lump sum benefit	– taxable amount calculated on the above formula	= tax-free amount
R8 721 000	– R5 070 349	= R3 650 651

The amount of R5 070 349 of the total lump sum benefit of R8 721 000 will be subject to tax and Joanne will get the balance of R3 650 651 tax-free. On 31 May 2023, the withdrawal tax table will apply on the taxable lump sum benefit of R5 070 349 as follows (rounded to nearest rand):

Taxable income from lump sum benefits	Rate of tax
0 – R27 500	0%
R27 501 – R726 000	18% of the amount above R27 500
R726 001 – R1 089 000	R125 730 + 27% of the amount above R726 000
R1 089 001 and above	R223 740 + 36% of the amount above R1 089 000

Tax = R223 740 + 36% of (R5 070 349 – R1 089 000)
= R223 740 + 36% of R3 981 349
= R223 740 + R1 433 286
= R1 657 026

Result:

Total lump sum	R8 721 000
Tax payable	R1 657 026
Nett lump sum, after tax	R7 063 974

Example 11: Resign from the municipality on 31 January 2023, transfer the withdrawal benefit from the municipal fund to a pension preservation fund, take the pre-1 March 1998 tax-free benefit as a pre-retirement withdrawal from that pension preservation fund immediately thereafter, and retire from that pension preservation fund on 31 May 2023, taking the maximum lump sum benefit.

The pre-1 March 1998 tax-free amount on the resignation benefit of R8 721 000 as at 31 January 2023 has already been calculated under example 10 to be R3 650 651.

If Joanne only takes this R3 650 651 as a pre-retirement withdrawal benefit from the pension preservation fund, there will be no tax payable on it because it qualifies as a deduction under paragraph 6(b)(v) of the Second Schedule to the Income Tax Act.

The total retirement benefit as at 31 May 2023 is R8 721 540. After deducting the R3 650 651 that was taken as a pre-retirement withdrawal benefit, the remainder is R5 070 889. On retirement, Joanne is limited to one-third as a lump sum, that is R5 070 889 ÷ 3 = R1 690 296. The retirement tax table will apply on the lump sum benefit of R1 690 296 as follows (rounded to nearest rand):

Taxable income from lump sum benefits	Rate of tax
0 – R550 000	0%
R550 001 – R770 000	18% of the amount above R550 000
R770 001 – R1 155 000	R39 600 + 27% of the amount above R770 000
R1 155 001 and above	R143 550 + 36% of the amount above R1 155 000

Tax	=	R143 550 + 36% of (R1 690 296 – R1 155 000)
	=	R143 550 + 36% of R535 296
	=	R143 550 + R192 707
	=	R336 257

Result:

Total lump sum	R5 340 947*
Tax payable	R336 257
Nett lump sum, after tax	R5 004 690

* R3 650 651 + R1 690 296

Joanne will also have to pay tax on the annuity purchased with the balance of the retirement benefit (R5 070 889 - R1 690 296 = R3 380 593) as and when she receives an income from that annuity, at her marginal tax rate.

Example 12: Resign from the municipality on 31 January 2023, transfer the withdrawal benefit from the municipal fund to a pension preservation fund, take the pre-1 March 1998 tax-free benefit as a pre-retirement withdrawal from that pension preservation fund immediately thereafter, and retire from that pension preservation fund on 31 May 2023, taking only R550 000 as a lump sum benefit.

The pre-1 March 1998 tax-free amount on the resignation benefit of R8 721 000 as at 31 January 2023 has already been calculated under example 10 to be R3 650 651.

If Joanne only takes this R3 650 651 as a pre-retirement withdrawal benefit, there will be no tax payable on it because it qualifies as a deduction under paragraph 6(b)(v) of the Second Schedule to the Income Tax Act.

The total retirement benefit as at 31 May 2023 is R8 721 540. After deducting the R3 650 651 that was taken as a pre-retirement withdrawal benefit, the remainder is R5 070 889. If Joanne only takes R550 000 of her retirement benefit as a lump sum, there will be no tax payable on it.

Result:

Total lump sum	R4 200 651**
Tax payable	R0
Nett lump sum, after tax	R4 200 651

** R3 650 651 + R550 000

Joanne will also have to pay tax on the annuity purchased with the balance of the retirement benefit (R5 070 889 – R550 000 = R4 520 889) as and when she receives an income from that annuity, at her marginal tax rate.

If the intention is to get the maximum lump sum benefit without having to pay any tax on it, the option under example 12 is the most appropriate. That also leaves the member with more than 50% of his total benefit to buy an annuity.

The option under example 11 may be best if the income from the annuity is going to be taxed at a marginal tax rate of higher than 36%.

The differences between the different options can be summarised as follows:

Option	Money in pocket	Tax paid	Available for annuity
1: Retire from MGF on 31 May 2023 – example 8	R3 243 289	R336 209	R5 814 160
2: Transfer retirement benefit from the municipal fund to a pension preservation fund and retire from that pension preservation fund on 31 May 2023 – example 9	R2 907 180	R0	R5 814 160
3: Resign from municipality on 31 January 2023, transfer withdrawal benefit from municipal fund to a pension preservation fund and take a full pre-retirement withdrawal from that pension preservation fund on 31 May 2023 – example 10	R7 063 974	R1 657 026	R0
4: Resign from municipality on 31 January 2023, transfer withdrawal benefit from municipal fund to pension preservation fund, take pre-1 March 1998 tax-free benefit as pre-retirement withdrawal from that pension preservation fund immediately thereafter, and retire from that pension preservation fund on 31 May 2023, taking the maximum lump sum – example 11	R5 004 690	R336 257	R3 380 593
5. Resign from municipality on 31 January 2023, transfer withdrawal benefit from municipal fund to pension preservation fund, take pre-1 March 1998 tax-free benefit as pre-retirement withdrawal from that pension preservation fund immediately thereafter, and retire from that pension preservation fund on 31 May 2023, taking only R550 000 as a lump sum – example 12	R4 200 651	R0	R4 520 889

I. Impact of the formula C deduction on divorce

When a member of a public sector fund gets divorced and his pension interest is divided, both the member and the non-member spouse will fully retain the exemption for years of service before 1998.

The Media Statement issued on 13 March 2012 on the *National Budget Review, 2012: Taxation of divorce order-related Retirement benefits*, stated as follows on p3:

> *' Note that when applying for a tax directive in respect of pension interest payable by a public sector fund, the retirement fund or administrator must include the pre-1 March 1998 years of service of the member ex-spouse when applying for the tax directive in the name of the non-member ex-spouse. The intention is to apply Formula C to pension interest payable by the public sector fund to either the non-member or the member ex-spouse on a continuing basis.'*

The Explanatory Memorandum on the Taxation Laws Amendment Bill, 2012, published on 10 December 2012, contains the following paragraph on page 8:

> *' B. The GEPF and other public sector funds*
>
> *Given the changed regulatory environment for public sector funds, it is proposed that all public sector fund members be placed on an equal footing with private sector fund members in tax terms, thereby fully implementing the "clean-break principle." Both ex-spouses will now be taxed in accordance with their own economic interests. Furthermore, it is proposed that the exemption for pre-1998 years of service be fully retained by both ex-spouses. Hence, both the member and the member's ex-spouse will retain the relief to the extent the retirement fund pay-out relates to pre-1998 years of service.*
>
> ***Example***
>
> ***Facts**: Mr A joins Government in 1990. He remains in service until 2014. In 1992 he marries Ms D. They get divorced in 2008. According to the divorce order, Ms D is entitled to 40 per cent of Mr A's retirement interest as at the date*

of divorce. On the date of divorce, Mr A's retirement interest is valued at R2 000 000. Ms D is therefore entitled to R800 000. In 2012, Ms D elects to receive the benefit, and the retirement fund pays Ms D R800 000 less any tax liability.

***Results**: With regards to the application of the relief in respect of pre-1998 years, the calculation of the taxable amount will be:*

Completed years of service of the member post-1998 as at date of the lump sum becoming payable (1998 – 2012)	*14 years*
Total completed years of service of the member as at date of the lump sum becoming payable (1990 – 2012)	*22 years*
Value of lump sum becoming payable	*R800 000*

$$\frac{14 \text{ years}}{22 \text{ years}} \boldsymbol{X} \text{ R800 000,}$$

= R509 091 (taxable lump sum)'

The amendments to the Second Schedule of the Income Tax Act were made in the Taxation Laws Amendment Act No. 22 of 2012.

Paragraph 2(1)(b)(iA) of the Second Schedule provides as follows with regards to the amount to be included in a non-member spouse's gross income:

'2. (1) Subject to section 9(2)(i) and paragraphs 2A, 2C *and* 2D*, the amount to be included in the gross income of any person in terms of paragraph (e) of the definition of "gross income" in section 1 shall be—*

(b) any amount—

(iA) assigned in terms of a divorce order granted on or after 13 September 2007 under section 7(8)(a) of the Divorce Act, 1979 (Act No. 70 of 1979), to the extent that the amount so assigned—

(aa) constitutes a part of a pension interest, as defined in section 1 of the Divorce Act, 1979 (Act No. 70 of 1979), of a member of a pension fund, pension preservation fund, provident fund, provident preservation fund or retirement annuity fund; and

(bb) is due and payable on or after 1 March 2012 to a person who is the former spouse of that member by that pension fund, pension preservation fund, provident fund or provident preservation fund or retirement annuity fund.'

Paragraph 2A of the Second Schedule addresses the protection of pre-1998 public sector fund benefits as follows:

'2A. Where any lump sum benefit is received or accrues from a public sector fund, the amount to be included in the gross income of any person in terms of paragraph (e) of the definition of "gross income" in section 1 shall be deemed to be an amount equal to the amount determined in accordance with the following formula:

$$A = \frac{B}{C} \times D$$

This paragraph stipulates that the formula will be applied to a lump sum benefit paid from a public sector fund that is added to a person's gross income in terms of paragraph (e) of the definition of 'gross income' in section of the ITA.

Paragraph (e) of the definition of 'gross income' in section of the ITA includes a *retirement fund lump sum benefit or retirement fund lump sum withdrawal benefit* in a person's gross income.

‘Retirement fund lump sum withdrawal benefit’ as defined in section 1 of the Income Tax Act in turn refers to *an amount determined in terms of paragraph 2(1)(b) of the Second Schedule*.

This full circle that started with paragraph 2(1)(b) of the Second Schedule, skipped to paragraph 2A of the Second Schedule and then took a detour through the definitions of ‘*gross income’* (par (e)) and ‘*retirement fund lump sum withdrawal benefit’*, and finally came back to paragraph 2(1)(b) of the Second Schedule, confirms that formula C should be applied to pension interest payable by a public sector fund to a non-member spouse.

J. Vested/non-vested benefit in a public sector fund

With effect from 1 March 2021, provident and provident preservation funds were aligned to pension, pension preservation and retirement annuity funds to make it compulsory for a member of a provident or provident preservation fund to purchase an annuity with at least two-thirds of their retirement benefit, unless the total retirement benefit is less than R247 500.

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, are protected and can still be taken as a lump sum. This protected pre-1 March 2021 benefit is referred to as a *vested benefit. 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.

*This must be clearly distinguished from a public sector fund member’s pre-1998 vested rights, which relates to benefits accrued in the public sector fund prior to 1 March 1998.

The vested benefit of a member of a provident fund on 1 March 2021 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 1 March 2021, plus the growth thereon, constitutes the member’s non-vested benefit, which is subject to annuitisation.

Refer to paragraph 1 of *Legal Update 3 of 2021: Taxation Laws Amendment Act No. 23 of 2020* for a detailed discussion on the annuitisation of provident funds.

In response to the question whether a benefit received by a receiving fund from a public sector fund should be seen as a vested benefit or a non-vested benefit if no split between the two is indicated on the transfer documents, SARS confirmed as follows in a non-binding private opinion (NBPO) on 9 March 2022:

> ‘ *There is no provision in the Income Tax Act which states that any amount transferred from a public sector fund, such as the GEPF, to any fund other than a public sector fund can be deemed similar to the vested portion (protected) of a lump sum benefit. <u>This includes a vested portion, originally transferred from a provident fund or provident preservation fund</u>. Any conditions that the GEPF might stipulate in respect of the amount being transferred to any other public sector fund or any fund other than a public sector fund falls outside the scope of the Income Tax Act.*
>
> *……………………..*
>
> *It is therefore our understanding that any amounts transferred from a public sector fund to another pension fund, pension preservation fund, provident fund, provident preservation fund or retirement annuity fund, as defined in section 1(1) of the Income Tax Act, can currently be regarded as “non-vested” by the receiving fund, <u>irrespective of whether an amount with a vested portion was previously transferred to that public sector fund</u>.’*

The Taxation Laws Amendment Act No. 20 of 2022, promulgated on 5 January 2023, amended the definitions of 'pension fund' and 'provident fund' in section 1(1) of the Income Tax Act to allow for the protection of the vested benefits of provident fund and provident preservation fund members who transfer their benefits to any public sector fund, including the GEPF, on or after 1 March 2023. This changes the underlined parts of the NBPO referred to above.

The position from 1 March 2023 will therefore be as follows:

a. Where a member of a public sector fund, who was never a member of any fund other than a public sector fund, transfers his benefit to another fund, the transfer benefit will be regarded as a non-vested benefit.

b. When a person, who was a member of a provident fund or provident preservation fund on 1 March 2021, transferred his benefit to a public sector fund before 1 March 2023, he would have forfeited his vested benefit protection. His total benefit would then be regarded as a non-vested benefit.

c. When a person, who was a member of a provident fund or provident preservation fund on 1 March 2021, transfers his benefit to a public sector fund on or after 1 March 2023, that transfer benefit will consist of a vested and a non-vested portion. The public sector fund must ensure that the vested benefit retains its protection. If the member subsequently transfers from the public sector fund to another fund, the transfer benefit will consist of the protected vested benefit plus growth thereon, which will remain protected as the vested benefit and the balance of the benefit will be regarded as non-vested.

d. When a person, who was a member of a fund other than referred to in (c) above, transfers his benefit to a public sector fund, the transfer benefit will be regarded as a non-vested benefit.

This can be summarised as follows:

Membership start date			**Classification of benefit on transfer or withdrawal after 01/03/2023**
≤ 01/03/2021	**01/03/2021 – 28/02/2023**	**> 01/03/2023**	**Transfer or withdrawal benefit after 01/03/2023**
Public sector fund	Public sector fund	Public sector fund	Non-vested
	Public sector fund	Public sector fund	Non-vested
		Public sector fund	Non-vested
Pension fund/pension preservation fund	Public sector fund	Public sector fund	Non-vested
Pension fund/pension preservation fund	Pension fund/pension preservation fund	Public sector fund	Non-vested
Pension fund/pension preservation fund	Provident fund/provident preservation fund	Public sector fund	Non-vested
Provident fund/provident preservation fund	Public sector fund	Public sector fund	Non-vested
	Provident fund/provident preservation fund	Public sector fund	Non-vested
	Provident fund/provident preservation fund	Public sector fund	Pre-1 March 2021 portion = vested

Provident fund/provident preservation fund			Post 1 March 2021 portion = non-vested
			Post 1 March 2023 portion = non-vested
Provident fund/provident preservation fund	Pension fund/pension preservation fund	Public sector fund	Pre-1 March 2021 portion = vested
			Post 1 March 2021 portion = non-vested
			Post 1 March 2023 portion = non-vested

K. Final thoughts

- Refer to the **important notes** under the different paragraphs.
- Consult the rules of the public sector fund before advising a client on their options.
- A member can find out if he has previously received a lump sum benefit that was taxed on the retirement fund lump sum benefit tax tables by following these steps on his SARS eFiling profile:
  - ✓ Select 'Services' on the menu bar
  - ✓ Select 'Tax Directives' on the menu on the left
  - ✓ Select 'Request Previous Years Directives'
- If the intention is for a member to only take that portion of his benefit that he will not pay any tax on and he has not taken any lump sums after 1 March 2007 that were taxed on the tax tables, the member should transfer his withdrawal benefit from the public sector fund to either a preservation fund or a retirement annuity fund. The following should then be considered:
  a. If the pre-1 March 1998 tax-free amount plus R550 000 is **less** than one-third of the total benefit, the member can retire directly after the transfer. It is then irrelevant which fund he transfers to. He can take a retirement lump sum equal to the tax-free amount + R550 000.
  b. If the pre-1 March 1998 tax-free amount plus R550 000 is **more** than one-third of the total benefit, the member must transfer to a preservation fund. He should then first take a pre-retirement withdrawal from the preservation fund equal to the pre-1 March 1998 tax-free amount and then thereafter retire.
     i. If his total remaining retirement benefit, after the deduction of the pre-retirement withdrawal, is more than R1 650 000, he can take R550 000 as a lump sum. If he has not received any lump sum that was taxed on the retirement fund lump sum benefit tax tables before, the full R550 000 should be taxed at 0%.
     ii. If it is less than R1 650 000, he will receive his full one-third as a tax-free lump sum.
- Keep in mind that the member's own contributions to a provident fund and contributions that were not taken into account previously will also be deducted from the lump sum benefit payable to the member on resignation or retirement. This can increase the tax-free lump sum benefit that a member can receive.

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