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RETIREMENT FUNDS IMPLICATIONS OF THE 2019 TAXATION LAWS AMENDMENT ACT AND THE 2019 TAX ADMINISTRATION LAWS AMENDMENT ACT

The 2019 Taxation Laws Amendment Act ("TLAA") and the 2019 Tax Administration Laws Amendment Act ("TALAA") were promulgated on 15 January 2020. However, various effective dates apply to different sections (as set out below).

These legislative amendments were, according to the National Treasury, required to implement the more complex tax announcements made in Chapter 4 and Annexure C of the 2019 Budget Review.

The **TLAA** focuses on the following key tax proposals announced in the 2019 Budget Review:

1. CORRECTING AN INADVERTENT LOOPHOLE: ALIGNING THE EFFECTIVE DATE OF TAX NEUTRAL TRANSFERS BETWEEN RETIREMENT FUNDS WITH THE EFFECTIVE DATE OF ANNUITISATION FOR PROVIDENT FUNDS

Background

Section 11F of the Income Tax Act ("the Act") provides for similar tax treatment for the deductions from taxable income of contributions to pension funds, provident funds and retirement annuity funds. Previously, contributions to these funds were treated differently for income tax purposes.

Further retirement fund reforms intended to harmonise the treatment of different retirement funds, dealt with the annuitisation requirements for provident funds. The primary objective of the 2013 amendments was to enhance preservation of retirement fund interests upon retirement and to have uniform tax treatment across the various retirement funds. This would result in provident funds being treated similarly (as the case is with deductions) to pension funds and retirement annuity funds, regarding the requirement to annuitise retirement benefits.

Effective date postponed

These retirement fund reform amendments were supposed to come into effect on 1 March 2015. Parliament, however, postponed the effective date for the annuitisation requirements for provident funds initially until 1 March 2016, then until 1 March 2019 and eventually 1 March 2021.

Inadvertent loophole

Each postponement of the effective date required several consequential amendments to various provisions of the Act. However, certain provisions were inadvertently left out of paragraph 6(1)(a) of the Second Schedule to the Act (dealing with the tax-neutral transfers between retirement funds). Failure to change the effective date in the provisions resulted in the non-taxable treatment of transfers from pension funds to provident or provident preservation funds taking effect from 1 March 2019.

The earlier effective date of 1 March 2019 for the tax neutral transfers from pension to provident or provident preservation funds created a loophole, as the intention was to align the effective date of the tax-neutral transfers from pension to provident or provident preservation funds with the effective date of retirement reform amendments, which is 1 March 2021.

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Correcting the loophole
To correct the inadvertent oversight, changes were made in the TLAA to align the effective date of the tax-neutral transfers from pension to provident or provident preservation funds with the effective date of retirement reform amendments, which is currently 1 March 2021.

2. ADJUSTING THE WITHHOLDING TAX TREATMENT OF SURVIVING SPOUSES' PENSIONS TO LIMIT TAX DEBTS ON ASSESSMENT

Background – a cash flow burden for surviving spouses
If a retirement fund member dies and a spouse's pension becomes payable by the fund to a surviving spouse who also receives a salary or other income, that salary or other income is added to the spouse's pension to determine his or her tax liability on assessment. The result of the assessment is often that the surviving spouse has a tax liability that exceeds the employee's tax withheld by the employer and the relevant fund during the year of assessment, since the aggregation of income pushes him/her into a higher tax bracket. This creates a cash flow burden for the surviving spouse.

Correcting the cash flow burden
In order to alleviate the financial burden in this regard, the TLAA provides that the normal tax rebates applicable to such surviving spouse should not be taken into account by the retirement fund when calculating the taxes to be withheld on the spouse's pension. Any PAYE excessively withheld will be refunded upon assessment. The provision will only be applicable in instances where recipients of the spouse's pension also receive other employment income.

Administration requirements
Fund administrators and insurers wishing to apply the tax rebates to the PAYE calculations for spouses will now have to establish whether the spouses receive additional income. Thereafter, the administrators and insurers must apply for an annual tax directive from SARS - the directive will advise the fund whether or not the fund should be disregarding the tax rebates when calculating the taxes due on amounts paid by it.

The amendment will come into operation on 1 March 2021.

3. VARIABLE REMUNERATION

In terms of section 7B of the Act, “variable remuneration” includes commission, travel allowances, bonuses, overtime pay and certain leave pay.

The TLAA has, with effect from 1 March 2020, extended the definition to include standby allowance and night shift allowance.

4. FOREIGN EARNINGS TAX

The TLAA has limited the exemption applicable to South African residents who earn income overseas and who work overseas for more than 180 days (at least 60 must be consecutive). Previously, such income was tax-exempt in RSA.

With effect from 1 March 2019, the tax-exemption applies only to a maximum of R1,000,000.00 earned overseas. Any amount above this threshold will be taxable.

From 1 March 2020, the amount has been adjusted to R1,250,000.00

5. ESTATE DUTY TAX

The contributions to pension, provident and retirement annuity funds are tax deductible but limited to 27.5% of the greater of remuneration or taxable income, up to a maximum of R350 000 per year. It is important to note that contributions *per se* are not limited to R350 000, only the amount that is deductible in any tax year.

In terms of the Estate Duty Act 45 of 1955, any excess non-deductible contributions resulting from large contributions made to retirement funds must be included in the member's estate for the purposes of calculating estate duty.

With effect from 30 October 2019, any person who dies after this date and who has made an excess contribution to the Fund will be taxed as follows:

If Mrs. X earns an annual salary of R325,000.00 and makes an excess contribution of R800,000.00 to her fund at the age of 76, but dies 2 years later -
27.5% of R325,000.00 = R89,375.00
2 x R89,375.00 = R178,750.00
Only the R178,750.00 will be free of estate duty [not the full R800,000.00].

6. REFINING THE TAX TREATMENT OF LONG-TERM INSURERS

In 2016, the legislature introduced a 'fifth fund' to the already complicated 'four fund' approach to the Long-Term Insurance legislation. On closer investigation the introduction of the 'fifth fund', or Risk Policyholder Fund (“RPF”), brought apparent administrative relief to many, as most of their policies could be lumped into this one fund leaving them with two funds, together with the 'Corporate Fund', instead of four or five to administer.

But it became apparent that the RPF could not house policies in terms of which annuities were being paid. This meant that once annuities became payable on a policy

which qualified as a 'risk policy' (until then residing in the RPF), they no longer qualified as risk policies and had to be transferred to the Untaxed Policyholder Fund ("UPF"). Many Long-Term Insurers had to establish and maintain a UPF for income tax purposes, thereby adding to the administrative burden of *inter alia*:

- separating the actuarially determined policyholder liability in respect of annuitised policies;
- expanding on its expense allocation calculations as directed by SARS in Binding General Ruling 30; and
- having to decide whether or not to raise a deferred tax liability on a return transfer credit remaining in the UPF.

The TLAA permits annuitised risk policies to remain in the RPF.

The proposed amendment will especially assist smaller Long-Term Insurers in administering their tax affairs by reducing the number of policyholder funds to administer.

7. CLARIFICATION OF TAX STATUS OF BULKING PROCEEDS HELD BY ADMINISTRATORS FOR DEREGISTERED FUNDS

Since 2009, retirement funds have been permitted to make tax-exempt bulking settlement payments to former fund members.

The TLAA now permits payments of these settlement amounts to be made directly by administrators to former members of deregistered funds on a tax exempt basis.

8. THE DEFINITION OF "WITHDRAWAL INTEREST"

The TLAA has changed the definition of withdrawal interest in the Act. It previously provided:

'withdrawal interest' means the value of the member's share of the pension fund, pension preservation fund, provident fund, provident preservation fund or retirement annuity fund value, as determined in terms of the rules of the fund, immediately prior to the date on which the member becomes entitled to a benefit from that fund because of an event other than the member attaining normal retirement age, as determined by the rules of the fund.

The section now reads as follows:

'withdrawal interest' means the value of the member's share of the pension fund, pension preservation fund, provident fund, provident preservation fund or retirement annuity fund value, as determined in terms of the rules of the fund on the date on which the member elects to withdraw due to an event other than the member attaining normal retirement age.

The change means that withdrawal benefits are now calculated on the date that the *member elects to withdraw from the fund* and not the date on which the member becomes eligible to receive a benefit.

9. ANNUITIES FROM A PROVIDENT OR PROVIDENT PRESERVATION FUND

The TLAA has, with effect from 1 March 2020, extended the scope of the Act to grant an exemption to retiring members of provident and provident preservation funds.
The exemption relates to voluntary annuities purchased by such members – they will now qualify for the same tax exemption applicable to members of other retirement funds.

Previously, non-exempt contributions could be offset against any taxable lump sum taken by a retiring member. This created an unfair situation for members who did not take lump sums and purchased compulsory annuities – as they could not offset their disallowed contributions. The Act was amended to allow those contributions to be set off against income earned from compulsory annuities. However, the amendment did not extend to retiring members of provident and provident preservation funds.

The TLAA has accordingly now rectified the situation.

The **TALAA** gives effect to the following tax proposal:
Inserting a provision that an executor need not submit a provisional tax return for the provisional period ending on the date of death

Paragraph 19 of the Fourth Schedule to the Income Tax Act, 1962 was amended by the substitution in subparagraph (1) for the proviso in item (a) of the following proviso:

> ''*Provided that—*
> *(i) such estimate will not include any retirement fund lump sum benefit,*
> *retirement fund lump sum withdrawal benefit or any severance benefit received by or accrued to or to be received by or accrue to the taxpayer during the relevant year of assessment; and*
>
> *(ii) in respect of the year of assessment in which a person dies, no estimate is required to be made in respect of the period ending on the date of death of that person.*''

The amendments mean that executors of deceased estates do not need to submit a provisional tax return for the provisional period ending on the date of death.