Retirement Fund Update

Quarter 1 of 2017

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Financial Services Board

1. Information Circular 1 of 2016: Persons responsible for payment of contributions

This circular relates to compliance and enforcement of section 13A of the Pension Funds Act, which relates to the payment of contributions to retirement funds.

In terms of section 13A (6) the principal officer or other authorised person is responsible for reporting on compliance with section 13A. Funds are reminded that unless the principal officer fulfils this role, the Registrar must be informed of the identity and details of the authorised person.

The circular also reminds funds that they must establish the identity of the person(s) at the employer who is/are personally responsible for compliance with sec 13A, i.e. "every director who is regularly involved in the management of the employer's overall financial affairs". A specimen letter from the fund to the employer requiring this information, is attached to the circular.

***Observation**: Funds must retain proof of sending and delivery of the letter as the Registrar may call upon them to furnish proof in the event of an inspection.*

2. Information Circular 2 of 2016: Duty to communicate with fund members

Boards of funds are reminded that they are legally obliged to communicate regularly with members, informing them of their rights, benefits and duties in terms of the fund rules.

Funds therefore need to obtain and maintain members' personal details for purposes of regular member communication and contacting the member when a benefit becomes payable.

***Observation**: It is becoming more and more important that funds are able to connect directly with members and not via messages sent by the employer. Many funds however complained that they find it difficult to obtain and maintain member contact details and requested the FSB for assistance. In many other jurisdictions it is a legal requirement for members and employers to provide members' personal contact details (email and cell phone numbers). In this circular the FSB makes the point that in their interpretation it the legal duty of the fund to obtain members' personal contact details. The information circular should however strengthen the hands of funds when they request the information from employers and members in terms of their operation requirements.*

3. Information Circular 3 of 2016: Vacancy on board of trustees

In terms of the Pension Funds Act, a vacancy on a board of trustees must be filled within a prescribed period. In terms of the circular, the prescribed period is 90 days from the date the vacancy arose.

In order for a board to take a valid decision during the 90-day period, the rules must specifically provide for such a decision to be valid. According to the circular such rule could read as follows: "Even though a vacancy on the Board may arise, when a decision is taken during the period prescribed in section 7A(1A) of the Act, it will not make that decision invalid provided the fund still complies with the provisions of section 7A(1) of the Act." The latter section provides that "notwithstanding the rules of a fund, every fund shall have a board consisting of at least four board members, at least 50% of whom the members of the fund shall have the right to elect."

***Observation**: It would be wise to incorporate the aforementioned proviso in the fund rules. Doing a special member election midterm can be problematic and funds are therefore encouraged to also adjust their member election protocols and make sure that those candidates who were not elected as trustees will serve as alternates and that these alternates will move forward (as trustees) as and when a vacancy occurs on the board.*

4. Information Circular 4 of 2016: Submission of annual financial statements

In terms of the Pension Funds Act the board of every fund must submit its annual financial statements within 6 months of the expiry of its financial year. Failure to do so is a contravention of the Act as well as non-compliance with the object and duties of the board and may lead to the Registrar finding that the board is not fit and proper to hold office. The circular states that the Registrar intends to impose a penalty of R60 per day for the late or non-submission of 2014 annual financial statements. Notification letters will be sent to the funds concerned and funds will be provided an opportunity to respond to the notification, as indicated in the letters.

***Observation**: When a penalty is imposed, the next question will typically be "who caused the delay?" Funds are advised to make sure that the service level agreement of the administrator and the terms of reference of (especially) the audit committee unpacks the process and the deadline dates properly and ensure that these dates are included in the fund's year planner.*

5. Information Circular 5 of 2016: Application for tax directives in case of section 14 transfers

The aim of this circular is to clarify whether or not the transfer of an individual member who voluntarily elected the transfer to another fund is a transfer of business as contemplated in terms of section 14 of the Pension Funds Act.

The circular mainly confirms the contents of Directive PF No 6, and, among other things, confirms that the following transfers are exempt from the requirement of obtaining the Registrar approval for the transfer in terms of section 14(1):

- Transfers from a pension/provident fund to an unclaimed benefit fund
- Transfers between unclaimed benefit funds
- Transfers between retirement annuity funds
- Transfers between preservation funds

***Observation**: The last paragraph of the circular states that a tax directive must be obtained where an individual member voluntarily elected the transfer to another fund, as well as in the case of a section 14 transfer from a pension fund to a provident fund. Although this is not expressly stated, it is implied that a tax directive must also be applied for in the case of all the aforesaid exempt transfers.*

Although not mentioned in the circular, it should be noted that the Tax Administration Laws Amendment Act, 2016 amended the Income Tax Act to effectively require tax directives in respect of all transfers of business as contemplated in section 14, including even bulk transfers. Indications are that administrators will be allowed to make bulk directive applications in case of bulk transfers.

Corporate Governance

6. King IV Report on Corporate Governance

The King IV Report on Corporate GovernanceTM (King IV) was launched on 1 November 2016. King IV is effective in respect of financial years commencing on or after 1 April 2017.

6.1. What is new?

- The vocabulary is no longer listed company specific. It contains a special supplement to help adapt the Code to retirement funds and other entities.
- The 75 principles have been reduced to a mere 17,
- Principle 17 is specifically applicable to institutional investors such as retirement funds. King IV places much greater emphasis on the requirement that the principles and practices of responsible investing as advocated in CRISA be applied by all retirement funds as a matter of good governance.
- King IV is focused on outcomes. It seeks to ensure that the objectives have been achieved rather than focus on the practices that have been implemented.
- King IV requires funds to “apply and explain”. The reader of the explanation must be able to make an informed decision about whether the organisation has achieved the principles and realised the four outcomes of ethical culture, performance in a sustainable manner, effective controls and legitimacy.

6.2. What are the consequences of non-compliance?

King IV is a set of voluntary principles and good practices of corporate governance. If King IV conflicts with any legislation, the legislation will prevail. However, for entities with a primary listing on the JSE Limited Securities Exchange certain aspects of King IV are binding by virtue of the listings requirements imposing obligations on issuers to comply therewith.

Observation*: The fact that King IV is not legally binding in itself does not mean that there are no legal consequences arising from non-compliance. A court will consider King IV when evaluating what is regarded as good practice in a particular situation, especially where governance duties are involved. Failure to meet corporate governance good practice, and by implication the principles set out in King IV, may invoke liability in certain circumstances.*

6.3. The 17 principles

Principle 1: The board should lead ethically and effectively.

Ethical and effective leadership by the board is exemplified by integrity, competence, responsibility, accountability, fairness and transparency.

Principle 2: The board should govern the ethics of the fund in a way that supports the establishment of an ethical culture.

In addition to setting an example through its own character and behaviour, the board should also ensure that the ethics of the fund is governed effectively. The board must satisfy itself that the fund's service providers manage their ethics effectively though codes of conduct, ethics policies and supporting processes.

Principle 3: The board should ensure that the fund is and is seen to be a responsible corporate citizen.

A fund's investment analyses and practices, whether executed by the fund itself or an asset or fund manager or other service provider, must take account of sustainability including environmental, social and governance (ESG) considerations as provided for in the Code of Responsible Investing in South Africa (CRISA).

Principle 4: The board should appreciate that the fund's core purpose, its risks and opportunities, strategy, business model, performance and sustainable development are all inseparable elements of the value creation process.

The performance of a retirement fund consists of delivering targeted investment returns in terms of its investment strategy without irresponsible risk-taking, and managing expenses to maximise value for money.

Principle 5: The board should ensure that reports issued by the fund enable stakeholders to make informed assessments of the fund's performance and is short, medium and long-term prospects.

Reports that are underpinned by integrated thinking and that present information about the resources and relationships on which the fund relies, its activities, outputs and outcomes in an integrated manner, are an effective way of informing stakeholders about the retirement fund's performance.

Principle 6: The board should serve as the focal point and custodian of corporate governance in the fund.

The board's status as the focal point and custodian of corporate governance is a natural consequence of its fiduciary duties towards the members of the fund. This common law duty originates from the fact that the board is entrusted with assets and interests, other than its own.

Principle 7: The board should comprise the appropriate balance of knowledge, skills, experience, diversity and independence for it to discharge its governance role and responsibilities objectively and effectively.

One of the ways in which this principle can be achieved is by using external expertise to assist the board with its oversight duties in the event that objective input on specific matters outside its knowledge, skills and experience is required.

Another manner in which balanced board composition can be accomplished is for employers or sponsors to use their powers of appointment to ensure that the board has members with the necessary expertise and experience. Also, a process of engagement with the employees who elect retirement fund board members should be initiated to convey the nature of board members' duties and the competencies required, so that informed elections take place.

Fund benefits from board members who are independent in appearance as this supports balanced, objective decision-making in the best interests of the fund and its members. It is recommended that at least half of the members of the board are independent and appointed from a pool of professional board members. Smaller funds should consider appointing at least one independent, professional board member.

Observation*: We fully support the recommendation for independent professional trustees in respect of commercial umbrella funds. In standalone funds the appropriate balance of knowledge, skills, experience, diversity and independence is typically achieved with a representative board on which at* *least 50% of the trustees are elected by the members, supported by a principal officer with the required training and experience.*

Principle 8: The board should ensure that its arrangements for delegation within its own structures promote independent judgement, and assist with balance of power and the effective discharge of its duties.

This principle deals with the establishment of board committees, for example the boards of all funds that undergo a statutory audit should consider having an audit committee, to ensure proper oversight of the quality of the audit and the independence of the auditor. Retirement funds should also consider appointing an investment committee to set investment strategy and monitor the performance of asset and fund managers against the strategy. Death and disability committee may be appropriate for larger funds.

Principle 9: The board should ensure that the evaluation of its own performance and that of its committees, its chair and its individual members, support continued improvement in its performance and effectiveness.

The results of the performance evaluations should be responded to by the board so as to achieve continued improvement in its performance and effectiveness.

Principle 10: The board should ensure that the appointment of, and delegation to, management contribute to role clarity and the effective exercise of authority and responsibilities.

When administrative and investment functions are outsourced, mechanisms and processes should be introduced for adequate and effective oversight in the same way as the board would have done if all these functions were conducted by the management of the fund. The board should ensure that a clear mandate is in place between the retirement fund and the fund administrator and other service providers. The board must be especially proactive in overseeing how service providers manage conflicts of interest.

The board should ensure that it has access to professional and independent guidance on corporate governance and its legal duties. It should also ensure that it has support to coordinate the functioning of the board and its committees. For companies, this role is fulfilled by the company secretary. As a matter of leading practice, it is recommended that boards of retirement funds appoint a suitably experienced professional to provide these services.

***Observation**: Batseta has made great strides in the registration of a principal executive officer qualification and is in the process of rolling out training and recognition of prior learning procedures. In the next few years, funds will be compelled to adjust their PO requirements and* appoint a suitably experienced professional.

Principle 11: The board should govern risk in a way that supports the fund in setting and achieving its strategic objectives.

Principle 12: The board should govern technology and information in a way that supports the fund setting and achieving its strategic objectives.

Principle 13: The board should govern compliance with applicable laws and adopted, non-binding rules, codes and standards in a way that supports the fund being ethical and a good corporate citizen.

Principle 14: The board should ensure that the fund remunerates fairly, responsibly and transparently so as to promote the achievement of strategic objectives and positive outcomes in the short, medium and long term.

Principle 15: The board should ensure that assurance services and functions enable an effective control environment, and that these support the integrity of information for internal decision-making and of the fund's external reports.

Principle 16: In the execution of its governance role and responsibilities, the board should adopt a stakeholder-inclusive approach that balances the needs, interests and expectations of material stakeholders in the best interests of the fund over time.

The stakeholders of a retirement fund include, among others, the members of the fund, their dependants and nominees, the participating employer, the sponsor (if different from the participating employer), the Registrar of Pension Funds and the respective service providers.

Principle 17: The board should ensure that responsible investment is practiced by the fund to promote the good governance and the creation of value by the companies in which it invests.

The principles and practices of responsible investing as advocated in CRISA should be applied by all retirement funds as a matter of good governance.

Observation*: Our investment and benefit consultants will guide trustees on the most practical and cost effective ways in which compliance with King IV can be assured. Those funds who implemented the strategies and solutions we offered in relation to King III should not have a significant list of items to attend to.*

Retirement reform

7. T Day legislation

On 21 September 2016 the Standing Committee on Finance expressed concern in Parliament about the lack of a policy position on retirement reform, following the postponement of the compulsory annuitisation requirement in respect of provident funds until 1 March 2018.

Progress was delayed because the trade unions felt that the matter could only be discussed in the context of the Social Security Reform Paper to be published by Government. The Committee urged the Minister of Finance and the Minister of Social Development to finalise the paper for consideration by the cabinet as soon as possible.

8. The Comprehensive Social Security Discussion Paper

8.1. Media statement

On 25 November 2016 Government tabled the much-anticipated consolidated paper on Comprehensive Social Security Reform at NEDLAC.

Minister of Social Development, Ms Bathabile Dlamini informed NEDLAC that the paper was initiated in 2006 when Cabinet appointed an Inter-Ministerial Committee on Comprehensive Social Security Reform, chaired by the Minister of Finance. Two papers on comprehensive social security were tabled in Cabinet since 2012; one by the National Treasury in 2012 and another by the Department of Social Development in 2015 (the latter paper was never released). During 2016, Cabinet endorsed these recommendations, preferring the proposals contained in the 2012 discussion paper.

8.2. Key Reform proposals

Establishment of a social security fund

The central reform proposal is the introduction of a National Social Security Fund, a centrally managed public fund to provide pensions, death and disability benefits and unemployment benefits.

All employers and employees will be obliged to contribute at a combined rate of 12 per cent of qualifying earnings up to a ceiling that will be aligned with the UIF earnings threshold (at the time when the paper was drafted the threshold was R149 736 per year but it has since increased to R178 464). The said 12% includes unemployment insurance contributions of 2%. Government will subsidise the contributions of low-income workers to minimise disruptions to the demand or supply of labour associated with the introduction of mandatory contributions.

It is proposed that employees with earnings below an agreed threshold (R13 000 per year) should not be obliged to contribute to the NSSF for retirement or risk benefits. A simplified contributions arrangement for self-employed individuals and informal workers will also be established.

The NSSF will be run on a defined-benefit basis. A worker's pension in retirement will be based on his or her career-average earnings and the duration of contributions while the disability and survivor benefit will be based on salary at the time of injury or death. The NSSF will pay a flat-rate funeral benefit.

The NSSF will provide income protection benefits for all workers and their families in combination with revised social assistance entitlements. However, those earning above the UIF earnings threshold will need to contribute to supplementary retirement savings and insurance arrangements to ensure an adequate replacement income.

Regulatory reform of the pensions and life insurance industry

Workers earning above the tax threshold (currently R75 000 per year for persons under 65) will be encouraged to contribute to a supplementary pension and insurance plan in addition to their NSSF contributions to ensure adequate provision in the event of death or disability and an adequate income in retirement.

A default rule is proposed, under which employers will be obliged to enroll employees in a retirement fund unless an explicit choice to opt out is exercised. Preservation of retirement savings until the end of a worker's career will become compulsory, except under clearly specified circumstances.

Government will encourage contributions to approved retirement funds through the tax system. Such funds will need to meet stringent standards of care, prudence, governance, fiduciary responsibility, transparency and control of costs.

8.3. An integrated system of social security

The National Social Security Fund

Pensions: At retirement, a worker who contributed to the NSSF will receive a pension calculated according to a straightforward formula based on lifetime wages, length of service, and an accrual rate to determine what proportion of average earnings (up to the contribution ceiling) the worker would receive for every year worked.

Disability and survivor benefits: Income support will also be paid to a worker's dependants if he or she dies before retirement. The NSSF would pay a survivor benefit based not only on the worker's salary but also the number of dependants that the worker leaves behind.

The benefit will be paid out for each child until they reach age 18 or complete their education. Surviving spouses would receive a benefit for a limited period of time, to assist the household's adjustment to the loss of earnings.

Recipients of the disability benefit will be eligible for a pension if they reach retirement age. The benefit calculation will treat the years they received the benefit as years of service and base the career-average salary on their wages prior to suffering the disability (adjusted for wage inflation).

Funeral benefit: The NSSF will offer a flat-rate funeral benefit to all its members. This will replace the funeral benefits to which members might have been eligible from the social insurance funds.

Supplementary retirement funds

Automatic enrolment: A system of automatic enrolment is under consideration to encourage workers to make supplementary pensions and insurance contributions. Under such a system, an employer is obliged to enroll employees in the company's occupational scheme or another suitable arrangement in addition to their mandatory contributions to the NSSF, unless employees explicitly elect not to join. Employees may be permitted to choose their level of contribution.

Approved funds framework: Multi-employer (umbrella) funds will be subject to specific governance provisions, such as requiring employer and member representatives on the board of management.

One of the proposed qualifying criteria for approved funds is that they meet certain cost-efficiency standards.

In the voluntary savings environment, which is dominated by retirement annuities, proposals for an individual retirement funds framework include portability with no early termination penalties; greater product standardisation and disclosure; limited charge structures; and stronger investment regulation, including limitations on individual investment choice.

It is proposed that the approved funds framework, incorporate the mandatory preservation of retirement contributions and portability, with limited restricted withdrawals, to protect accumulated retirement savings from early withdrawals.

Annuitisation: Government proposes that it should be mandatory for retirement fund contributors to annuitise at least two-thirds of their supplementary retirement savings at retirement. Government is investigating whether it can provide an annuity product. This would pool mortality across the working population, provide protection against inflation and include an income for a spouse should the retiree die first. The monthly income would also be the same for men and women.

Low-cost pension fund: Government will give consideration to establishing a low-cost pension fund to run alongside the NSSF and the approved funds. Such a fund would be run on a defined-contribution basis. Where an employer cannot enroll employees in an occupational fund, they would instead be enrolled in the default fund.

Vested rights: The rights of current members and contributors who have accumulated funds or benefit entitlements under current rules will be assured. Member of retirement funds may be granted the opportunity to transfer accumulated retirement savings to the NSSF, but will not be obliged to undertake any actions related to accrued rights that might leave them in a proper position.

8.4. Impact of the NSSF on existing contributory funds

The first ten percent of all workers' retirement contributions on earnings up to the NSSF ceiling will go to the mandatory fund. As a result, occupational and voluntary funds will suffer a significant loss of business: they will henceforth be competing for supplementary savings over and above workers' contributions to the NSSF. It is furthermore likely to mean a significant change in benefit structure for many members.

The new environment will be particularly challenging for funds which cater for workers earning below the NSSF ceiling. Public sector funds will be significantly affected by the introduction of the NSSF. Their present contribution base will partly go to the new NSSF arrangement, with the remaining part converted into a supplementary fund complying with the approved funds framework.

8.5. Institutional framework

The proposed social security framework entails:

- The establishment of a single department with oversight for social security.
- The creation of National Social Security Fund.
- Single collection agency: SARS is proposed as a single collection agency, with employer and employee contributions gathered mainly through the monthly PAYE system. SARS could also collect supplementary contributions made through automatic enrolment or voluntary arrangements.
- A new regulatory framework: New regulations and an appropriate supervisory institution are required to ensure that the NSSF, social insurance funds and supplementary retirement arrangements comply with their legal obligations.

8.6. Consultation and provisional reform timetable

After feedback on these proposals is received from the public, Government will engage stakeholders in an intensive consultation process to ensure that these proposals are right for the country as a whole. Government's proposed implementation strategy will be sequenced in three broad phases:

- **Creating a unified policy platform:** A department responsible for social security will be established. This department will initiate the drafting of legislation associated with the new comprehensive social security landscape and develop implementation.
- **Establishment of the NSSF and institutional consolidation:** The NSSF will be established and will be aligned to the social insurance funds and social assistance platform.
- **Five-to-ten year transition for implementation of the NSSF:** Once a department responsible for social security policy-making and the NSSF are in place, a transition period of between five and ten years is proposed for alignment of existing retirement funds with the NSSF and the approved funds framework.

Observation: *In the covering email, we provide a link to the Simeka Comment on the Consolidated Paper on Comprehensive Social Security Reform.*

9. Defaults regulations

National Treasury published a second draft of the proposed default regulations on 9 December 2016.

The draft regulations will be incorporated into the regulations issued in terms of the Pension Funds Act and will require funds to make provision for the following defaults:

Default investment portfolio

The rules of defined contribution funds must make provision for a default investment portfolio which must comply with certain prescribed requirements and in which the retirement funding contributions of a member must be invested if the member has not selected another investment portfolio.

Default preservation and portability

If members are enrolled into a retirement fund as a condition of employment, the rules of that fund must make provision for paid-up benefits. When a member leaves the service of a participating employer before retirement, such member must be made a paid-up member of the fund until the fund is instructed by the member to pay his/her benefit or transfer his/her benefit to another fund. The member must also be provided with a paid-up membership certificate.

The rules of funds must make provision to accept any amount transferred to the fund from another fund for the benefit of a member. Funds must within four months of a member joining the fund obtain a list of all paid-up membership certificates in respect of any retirement savings of that member, and request the member whether he/she wishes to transfer the retirement savings held in respect of each paid-up membership certificate into the new fund.

Members must be given access to retirement benefits counselling before any withdrawal benefit is paid to them or any transfer is made on their behalf to another retirement fund.

Default annuity

All retirement funds must have an annuity strategy, which identifies a proposed annuity that is considered appropriate for the member to select. The member will not automatically be defaulted into the proposed annuity. The member will only be enrolled into it if he or she consents thereto.

The default annuity must comply with certain prescribed requirements including that members must be given access to retirement benefits counselling not less than three months before their retirement date.

***Observation**: Indications are that the default regulations can become effective as early as 2018. Implementing these requirements will require a great deal of work and careful thinking on the part of many funds. It will therefore be desirable for funds to do the research required and consider the options they provide during the course of this year.*

In the covering email, we provide a link to the Simeka Comment on the proposed default regulations.

Tax changes

The 2016 Taxation Laws Amendment Act and the 2016 Tax Administration Laws Amendment Act were published in the Government Gazette on 19 January 2017. The main provisions that would impact the employee benefits industry are the following:

10. Taxation Laws Amendment Act, 2016

Disallowing the Foreign Service exemption for a lump sum or pension from a local retirement fund

The provisions of section 10(1)(gC)(ii) of the Income Tax Act allow a South African tax resident who is employed outside South Africa (SA) to receive those retirement fund benefits, that accrued while outside the country, free from tax. In terms of the Amendment Act the exemption provided in section 10(1)(gC)(ii) will in future only apply to benefits from foreign retirement funds.

According to the Explanatory Memorandum to the Taxation Laws Amendment Act the reason for the change is that SA tax residents who work outside SA can receive a tax deduction on contributions made to a SA retirement fund (local retirement fund). The deduction can either be made in the same tax year if they have other forms of taxable income or worked partially in SA within that year, or the amounts can be rolled over to be deducted in a future year of assessment. Therefore, Government is of the view that upon receipt of the fund benefits the amount that accrued while the SA tax resident was employed outside SA should not be tax-free, as the industry believed to be the position up to now.

The exemption provided in section 10(1)(gC)(ii) has been amended to only apply to benefits from foreign retirement funds. The amendment comes into operation on 1 March 2017 and applies in respect of both lump sum benefits and pensions. SA tax residents already receiving a pension of which a portion was exempt from income tax (because of services rendered outside SA) will also be affected with effect from the said date. However, benefits paid to a SA tax resident arising from benefits from a foreign retirement fund that were transferred to a local retirement fund will remain tax exempt.

***Observation**: In the past where a person e.g. retired after 25 years of service of which 5 years were foreign service, SARS would in our experience have granted a tax directive indicating that 80% (20/25) of the lump sum and, if applicable, pension is taxable in SA. However if contributions were made to a SA fund during Foreign Service, the full benefit will in future be taxable in SA.*

Tax deductions in respect of fund contributions based on capital gains

The tax deduction allowed in terms of section 11(k) of the Income Tax Act in respect of retirement fund contributions is, in short, 27,5 per cent of the higher of the person's remuneration or taxable income, subject to a maximum of R350 000 per year.

Two amendments were made to section 11(k). The first one is that, in calculating taxable income in order to determine the maximum tax deduction, the taxable income before any section 18A deductions (donations to public benefit organisations) must be used.

The second amendment is that the following new paragraph has been inserted in section 11(k) and applies with effect from 1 March 2016:

"(v) any deduction in terms of this paragraph must apply for the purpose of determining the total amount of taxable income, before any deduction in terms of section 18A or the inclusion of any taxable capital gain of the person, whether derived from the carrying on of any trade or otherwise."

According to the Explanatory Memorandum to the Taxation Laws Amendment Act the harmonisation of the tax treatment of contributions in section 11(k) allowed for a deduction against income from "carrying on a trade", which unintendedly excluded passive income. The purpose of the insertion of section 11(k)(v) is to allow deductions against passive income.

Capital gains that form part of taxable income are included in the calculation of the maximum deduction, but the amount contributed in respect of such capital gains may however only be deducted against taxable income other than capital gains. This means that any excess that could not be deducted in a specific tax year will be carried over to the next tax year.

***Observation**: The following example (which is based on the example in the explanatory memorandum to the draft Taxation Laws Amendment Bill) illustrates the treatment of the contribution made in respect of a capital gain:*

John receives remuneration of R75 000 during the tax year and taxable interest of R10 000, while a capital gain of R300 000 also accrued to him. He contributes R100 000 to a retirement fund.

His taxable income (R385 000) is higher than his remuneration and the maximum tax deduction is therefore R105 875 (27, 5% of R R385 000). His contribution is therefore below the maximum.

The R100 000 may only be deducted against taxable income other than the capital gain, i.e. against R85 000 (R385 000 less R300 000). The R15 000 that is not deductible can be carried over and deducted in a subsequent tax year.

Formal emigration required for withdrawals from retirement annuity funds

In 2015, changes were made in the Income Tax Act to allow individuals to withdraw a lump sum from their retirement annuity fund when they cease to be a tax resident or when they leave South Africa at the end of their work visa.

The definition of "retirement annuity fund" has been amended with effect from 1 March 2016 to require that a member must emigrate from the Republic and that the emigration must be recognised by the South African Reserve Bank for purposes of exchange control before the member may withdraw a lump sum from his/her retirement annuity fund.

Determination of the fringe benefit for defined benefit contributions

Paragraph 12D of the 7th Schedule to the Income Tax Act (which deals with the valuation of contributions made by employers to certain retirement funds) includes a formula to calculate the taxable fringe benefit for contributions to a retirement fund that has a defined benefit component.

The formula in paragraph 12D is intended to take into account the retirement funding income that the retirement fund uses to calculate the required level of contributions given the expected liabilities of the fund. However, the definition of "retirement funding income" has referred to "remuneration" as contemplated in the Fourth Schedule to the Income Tax Act, which is a different income figure. Remuneration may also differ for two individuals depending on the level of travel allowance, leading to a situation where two identical members of the same defined benefit fund would have a different fringe benefit value for the employer contribution.

The definition of “retirement funding income” has therefore been changed to refer to the income taken into account in determining contributions made by or on behalf of the employer. The change applies in respect of contributions made on or after 1 March 2017.

The definition of “retirement funding income” also referred only to employer contributions and was silent on a situation where the employer is on a contribution holiday, i.e. where the employer contributions are funded from a reserve account in the fund. These types of contributions might have been interpreted to be exempt from the formula, creating a loophole. Changes have been made in paragraph 12D to adjust the definition of “retirement funding income” to include the last-mentioned contributions made by the fund on behalf of the employer. These changes are deemed to apply in respect of contributions made on or after 1 March 2016.

11. Tax Administration Laws Amendment Act, 2016

This Amendment Act, amended the Income Tax Act to effectively require tax directives in respect of all transfers of business as contemplated in section 14 of the Pension Funds Act, including bulk transfers. Indications are that administrators will be allowed to make bulk tax directive applications in case of bulk transfers.

With recognition to the major contributions made by Anton Swanepoel and Sanlam Employee Benefits: Law Services