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## Retirement Fund Update Quarter 2 of 2017

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## 1. Information Circular 1/2017: 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 objects 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 2015 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:** *Funds are encouraged to plot the process and timelines for the preparation and approval of the fund financials clearly in their annual year plan. In the unfortunate event of a late submission, it is important that the board is able to determine where the delays occurred and whether it is a service provider or the board that should take responsibility for the payment of any fine.*

## 2. Draft Information Circular on cancellations and terminations

The Financial Services Board (FSB) on 5 April 2017 issued the draft information circular on the cancellation of the registration of a fund; the termination of the participation of an employer in an umbrella fund; and the appointment of trustees in terms of section 26(2) of the Pension Funds Act, for comment by 15 May 2017. The circular seeks to provide urgently needed clarity on the requirements for the cancellation of the registration of a fund, and the termination of the participation of an employer in an umbrella fund. The circular further provides clarity on the appointment of trustees in terms of section 26(2) of the Pension Funds Act (“the Act”).

### 2.1. The cancellation of the registration of a fund

A fund will have ceased to exist when it no longer has any assets, liabilities or members, or any pending litigation against it. So as to enable the Registrar of Pension Funds (“the Registrar”) to be satisfied that a fund has ceased to exist, the Registrar must be provided with a declaration by at least two of the following persons:

- A former member of the board of the fund;
- The principal officer of the fund;
- A member of the board of the fund;
- The fund’s valuator or actuary who was the fund’s valuator immediately before the termination of the fund;
- The fund’s auditor;
- A representative of the fund’s administrator or former administrator.



If the fund has ceased to exist as a result of a full transfer in terms of section 14 of the Act, the above persons must in the declaration confirm that the fund has terminated as all assets, liabilities and members have transferred in terms of a full section 14 transfer.

If the fund has ceased to exist as a result of the last member receiving his/her benefit, the above persons must in the declaration confirm that they have taken all reasonable steps to ensure that all benefits due to members have been paid, and that the fund has no further assets, liabilities and members.

In both the above scenarios the relevant persons must also in the declaration confirm the following:

- that there are no outstanding contributions due to the fund;
- that there are no unresolved complaints in respect of the fund; and
- that they are not aware of any possible prejudice that may be incurred by any member or beneficiaries of the fund.

The Registrar will prior to the cancellation of a fund publish a notice of the intention to cancel the fund, in accordance with the requirements of the Promotion of Administrative Justice Act, on the FSB website, for a period of 30 days, during which period any person may submit reasons to the Registrar why the fund should not be cancelled.

## **2.2. The termination of the participation of an employer in an umbrella fund**

The participation of a participating employer in an umbrella fund will have terminated when the fund no longer has any assets, liabilities or members in respect of the participating employer, or any pending litigation against it in respect of the participating employer.

If the participation of an employer in an umbrella fund has terminated, the board of the umbrella fund must apply for the withdrawal of the registered special rules of such participating employer.

If the participation of the employer has terminated as a result of a full transfer in terms of section 14 of the Act, the Registrar must be furnished with a declaration by the chairperson of the umbrella fund confirming that the participation of the employer terminated, and that all assets have been transferred to the transferee fund.

If the participation of the employer has terminated as a result of the last member of the employer receiving his/her benefit, the Registrar must be furnished with a declaration by the chairperson of the umbrella fund confirming that the participation of the employer in the fund terminated. The chairperson must further confirm that he/she has taken all reasonable steps to ensure that all benefits due to members have been paid, and that the employer has no further assets, liabilities and members.



In both the above scenarios the chairperson of the umbrella fund must also in the declaration confirm the following:

- that there are no outstanding contributions due by the participating employer;
- that there are no unresolved complaints in respect of the participating employer; and
- that he/she is not aware of any possible prejudice that may be incurred by any member or beneficiaries in respect of the participating employer.

### **2.3. The appointment of trustees in terms of section 26(2) of the Act**

Section 26(2)(a) of the Act provides that the Registrar may make appointments to the board of a fund in the circumstances contemplated in section 26(2). The duties of a section 26(2) board are the same as that of any other board, and may be further expanded by the Registrar according to the circumstances of the fund. These duties may inter alia include the following:

- constituting a board in terms of the rules of the fund;
- management of the fund;
- ensuring compliance with all applicable laws;
- applying for exemption in terms of section 7B of the Act;
- submitting rule amendments to the Registrar for approval;
- entering into or renewing contracts and service level agreements with service providers;
- the approval and submission of outstanding annual financial statements, actuarial valuations, surplus apportionment schemes, regulation 28 quarterly reports and reports required by the South African Reserve Bank;
- collecting of outstanding contributions or schedules from any participating employer;
- opening a bank account in the name of a fund;
- taking investment decisions in accordance with the investment policy of the fund;
- providing members with annual benefit statements;
- transferring of assets, liabilities and members to other funds;
- paying benefits in terms of the rules of the fund;
- maintaining fidelity cover for the fund and its officers; and
- in the event that a valid board cannot be established – apply to the Registrar for the approval of the appointment of a liquidator; or apply for the cancellation of the fund.

**Observation:** *We welcome this information circular. Many employers experience a delay in the deregistration of old funds in which they participated. This circular will provide an opportunity to project manage all these old funds out of the system.*

### **3. Taxation Laws Amendment Act, 2016 and Tax Administration Laws Amendment Act, 2016**

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:



### **3.1 Taxation Laws Amendment Act, 2016**

#### **3.1.1 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 Bill 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 came 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.

#### **3.1.2 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 Bill the harmonisation of the tax treatment of contributions in section 11(k) allowed for a deduction against income from “*carrying on a trade*”, which unintentionally 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 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.

### **3.1.3 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.

### **3.1.4 Determination of the fringe benefit for defined benefit fund 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.

**Observation:** *We welcome these new measures. They are even handed and balanced in their approach.*

### **3.2 Tax Administration Laws Amendment Act, 2016**

The 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 even bulk transfers. Indications are that administrators will be allowed to make bulk tax directive applications in case of bulk transfers.

**Observation:** *This requirement has significant practical implications. To be able to submit a section 14 transfer for approval the fund must obtain the tax numbers of all the members to be able to obtain a tax directive in respect of each member. This requirement will cause additional work and is likely to cause delays.*

## **4. Binding General Ruling 25 of SARS: Exemption in respect of foreign pensions**

Section 10(1)(gC)(ii) of the Income Tax Act exempts from tax any lump sum or pension received by or accrued to a South African tax resident from a source outside South Africa as consideration for past employment outside South Africa.

In terms of the Taxation Laws Amendment Act, 2016, the exemption will as from 1 March 2017 no longer apply if the benefits are provided by a South African retirement fund, except in respect of any amount transferred to the fund from a source outside South Africa. The Explanatory Memorandum to the Taxation Laws Amendment Bill stated that the exemption will apply only to benefits from foreign retirement funds but the amended section 10(1)(gC)(ii) does not expressly refer to amounts transferred from foreign funds and instead refers to amounts transferred from a source outside South Africa.

In terms of the ruling the term “source outside the Republic” in section 10(1)(gC)(ii) refers the originating cause which gives rise to the fund benefits, i.e. where the services have been rendered. The ruling states that the following formula must be used to calculate the portion of a benefit that will be exempt due to services rendered outside South Africa:



Foreign services rendered x total benefit received or accrued.

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Total services rendered

**Observation:** *Certain aspects of BGR 25 require clarity and industry bodies will approach SARS in this regard.*

## 5. Tax on living annuities held by trusts

SARS recently confirmed that a living annuity can be paid to a trust. SARS was then requested to indicate if they will provide tax directives to administrators in respect of living annuities owned by trusts. Where the beneficiary or beneficiaries of a trust have vested rights to the income of the trust, such income is taxable in their hands.

During March 2017 SARS advised that the procedure to be followed in this regard is as follows:

- The trust must register for PAYE;
- The beneficiaries' details must be provided;
- The application for a directive must be submitted at the relevant SARS Branch Office; and
- Once the case number is issued by SARS that same case number must be sent to [dpietersen@sars.gov.za](mailto:dpietersen@sars.gov.za).

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