



WHAT IF MEMBER'S  
FUND VALUE IS  
INSUFFICIENT TO PAY  
COURT ORDER AND TAX

**Midnight**  
in the  
garden of good and evil

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## EXAMPLE OF PROBLEM

- 100% pension interest awarded to non-member spouse on divorce
- Tax on award to be paid out of member's funds
  - always has been and always will be the position in terms of the Income Tax Act re: divorces pre-13 September 2007 (all that has changed is date of accrual)
- Member's funds insufficient to pay both



## EXAMPLE OF PROBLEM cont.

- Theoretically problem always existed, but
  - before Pension Funds Amendment Act, 2007, non-member and tax only payable on member's exit from fund
  - Historically, in practice enough time between date divorce and member's exit to grow member's funds so sufficient to pay non-member spouse value at date divorce and tax (out of fund growth since divorce)



## EXAMPLE OF PROBLEM cont.

- Now “clean break” introduced by Pension Funds Amendment Act, 2007 = pay immediately
- Section 37D(4)(d) Pension Funds Act
  - portion pension interest assigned to non-member spouse accrues (except for purposes of tax) to member on 13 September 2007 if divorce pre-13 September 2007
- Section 37D(4)((a))
  - portion pension interest assigned to non-member spouse accrues to member on date divorce if post-13 September 2007



## EXAMPLE OF PROBLEM cont.

- Section 37D(1)(d) Pension Funds Act:
  - A registered fund may deduct from a member's benefit or minimum individual reserve-
  - (i) any amount assigned to a non-member spouse in terms of a divorce decree; and
  - (ii) employees' tax required to be deducted or withheld in terms of the Fourth Schedule to the Income Tax Act, as a result of the deduction in (i)



## EXAMPLE OF PROBLEM cont.

- Since introduction “clean break”, deduction from member’s funds may occur before any growth in benefit to fund 100% share to non-member and tax
- Tax liability and payment to non-member spouse occur simultaneously
- Section 7(11) Income Tax Act
  - any deduction under section 37D(1)(d) deemed to be income accrued to member on date deduction



## EXAMPLE OF PROBLEM cont.

- Section 37D(3) Pension Funds Act deals with order of preference given to claims against available pension interest for:
  - pre-existing housing loans;
  - maintenance orders;
  - earlier decree of divorce or dissolution of customary marriage
- No mention of ranking of claim for tax
- How resolve competing claims?



## ON ONE HAND - ORDER

- Court order, whether correctly or incorrectly granted, has to be obeyed until properly set aside
- Risk to fund if doesn't comply with court order entitling non-member spouse to share on divorce = writ or contempt
  - Warrant of execution against fund's assets for failure to pay
  - “civil contempt”: aggrieved party in civil litigation can approach court for assistance to compel performance of its order
    - court may impose fine or order imprisonment



# CONTEMPT OF COURT

- Requirements:
  - order granted against fund
  - fund served with order/informed of contents
  - fund disobeyed or neglected to comply
  - failure to comply was willful
    - Wilfulness normally inferred from non-compliance, then onus on fund to rebut inference on balance of probabilities
  - If contempt brought on application, guilt must be proved beyond a reasonable doubt



## CONTEMPT OF COURT cont.

- Sentence usually suspended, provided comply
- Fund can't be imprisoned
- But person “in de facto control”, in charge of day to day operations, the “controlling mind” can be:
  - trustees?
  - Administrator?
- Fund can be ordered to pay penalty



## ON THE OTHER HAND - TAX

- Para 2 of 4<sup>th</sup> Schedule of the Income Tax Act:
  - Any employer (includes administrator of pension, provident, retirement annuity, preservation fund)
  - Liable to pay remuneration (includes share of fund payable on divorce)
  - Must deduct from the benefit or minimum individual reserve of the employee (includes fund member)
  - All normal tax for which the member is liable



## LIABILITY & PENALTIES—4<sup>TH</sup> SC

- Para 4: amount to be deducted or withheld is debt due to the State and employer is “*absolutely liable*” for the due payment thereof
- Para 5: employer who fails to deduct or withhold the full amount of employees’ tax is “*personally liable*” for the amount it fails to deduct or withhold
- Para 6(1): fail to pay on time = penalty of 10% of amount not deducted or withheld
- Para 6(2A): intent to evade = penalty up to double the amount not deducted or withheld



## POSSIBLE SOLUTION

- Para 3 of 4<sup>th</sup> Schedule of Income Tax Act
- Tax first, non-member's claim reduced
  - If obligation to deduct and pay non-member spouse arises from court order (as opposed to legislation):
    - Section 7(8) Divorce Act empowers (but does not oblige) court to grant order against fund for deduction and payment of member's pension interest to non-member
  - Issue is Section 37D(4)(a) Pension Funds Act



## PARA 3 OF 4<sup>TH</sup> SCHEDULE

*“The liability of any employer to deduct or withhold any amount of employees’ tax in terms of paragraph 2 shall not be reduced or extinguished by reason of the fact that the employer has a right or is otherwise than in terms of any law under an obligation to deduct or withhold any other amount from the employees’ remuneration, and such right or obligation shall notwithstanding anything to the contrary in any other law contained, for all purposes be deemed to have reference only to the amount of the remuneration remaining after the amount of employees’ tax referred to in that paragraph has been deducted or withheld”*



## POSSIBLE SOLUTION cont.

- Arguable that portion pension interest awarded in divorce order is deemed to refer to balance remaining after deduction of tax (in terms of para 3 of 4<sup>th</sup> Schedule)
- BUT:
  - “*otherwise than in terms of any law*” = legislation (in this context)
  - Section 37D(4)(a) Pension Funds Act
    - obligatory: “*portion of pension interest assigned to non-member spouse in terms of a decree of divorce ... must be deducted*”



## CONFLICTING LAWS

- Literal interpretation of statutes = conflict
  - (fund can't give effect to both obligations to deduct tax and deduct amount allocated to non-member spouse in court order)
- Pension Funds Act and Income Tax Act both national legislation of SA
  - Can't rely on ranking of constitution, foreign and provincial legislation
- Rules of Interpretation: adopt purposive or teleological approach



## INTENTION OF LEGISLATURE

- Ranking of tax claims:
- Preference against “free residue in insolvent estate:
  - Section 99(1)(iv) Insolvency Act
    - Any amount which the insolvent deducted or withheld by way of employees’ tax under 4<sup>th</sup> Schedule Section
  - Section 101 Insolvency Act
    - Any tax on persons for which the insolvent was liable under any Act of Parliament



## CONCLUSION

- Deduction of tax is fund's primary obligation
  - tax liability not reduced
- Rely on paragraph 3 of 4<sup>th</sup> Schedule of Income Tax Act to “read down” court order to refer to 100% of pension interest remaining after tax
  - liability to non-member spouse reduced
  - fund not in contempt of court



# THE END

- QUESTIONS?

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