

**REPORT TO MEMBERS OF THE PENSION LAWYERS  
ASSOCIATION ON THE MEETING OF THE INSTITUTE OF  
RETIREMENT FUNDS (IRF) LEGAL AND TECHNICAL COMMITTEE  
HELD ON 21 AND 22 JANUARY 2009**

1. The Financial Services Laws General Amendment Act, 2008 came into effect on 1 November 2008. Related draft regulations (dealing with beneficiary funds, principal officers, umbrella funds and unclaimed benefit funds) are being considered by the Minister of Finance.
2. The new draft regulation 28 (dealing with retirement fund investments) has been prioritized ahead of the other regulations and will be circulated for comment.
3. After 1 January 2009, death benefits under section 37C of the Pension Funds Act can only be paid into beneficiary funds that have been registered. Some beneficiary funds have been registered by the FSB and administration licenses in terms of section 13B of the Pension Funds Act have been issued in respect of the administration of certain beneficiary funds (with others being granted temporary exemptions).
4. Unclaimed benefit funds (which will be pension preservation or provident preservation funds) will be registered as soon as the FSB and SARS have agreed a checklist for the registration and approval requirements (so as to facilitate the "one-stop" approach to fund registration and approval by the FSB with delegated authority from SARS).
5. The tax payable on unclaimed benefits will continue to be governed by GN35 until 28 February 2009, thereafter the provisions of the Pension Funds Act (as amended by the Financial Services Laws General Amendment Act, 2008) and the Income Tax Act (as amended by the Revenue Laws Amendment Act, 2008) will apply (with the option of a tax-free section 14 transfer of an unclaimed benefit to from an approved pension, provident or retirement annuity fund to an approved unclaimed benefit fund).
6. The Revenue/Taxation Amendment Bill for 2009 is likely to be released on 18 February 2009 for public comment. It is anticipated that the Bill will:

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- 6.1 amend the definitions of "pension preservation fund" and "provident preservation fund" in the Income Tax Act to accommodate transfers from occupational funds;
- 6.2 correct paragraph (air) of the Second Schedule of the Income Tax Act to clarify that the non-member spouse will bear the tax in respect of divorce orders granted after 13 September 2007 where the deduction from the member's minimum individual reserve occurs after 1 March 2009 (while the position will remain that the member is liable to be taxed if the divorce was granted after 13 September 2007 and the deduction from the member's minimum individual reserve occurs before 1 March 2009);
- 6.3 correct paragraphs 2(b) and 4(4) of the Second Schedule of the Income Tax Act with retrospective effect to ensure that payments to non-member spouses in terms of divorce orders handed down before 13 September 2007 must be taxed in the hands of the member spouse before and after 1 March 2009;
- 6.4 Address maintenance payments by way of deduction from retirement benefits.
7. The Taxation Laws Amendment Act, No. 3 of 2008 introduced the definition of "living annuity" into the Income Tax Act. Prior to this, living annuities were regulated by SARS Practice Notes, namely RF1/96 and addenda thereto.
- 7.1 In terms of paragraph (b) of the definition of living annuity as now contained in the Income Tax Act, the amount of the annuity is determined in accordance with a method or formula prescribed by the Minister by notice in the Gazette (currently between 2.5% and 17.5% of the value of the assets referred to in paragraph (a) of the definition of living annuity).
- 7.2 Further requirements regarding living annuities may be prescribed by the Minister by notice in the Gazette, which is imminent. The Minister has been requested to circulate the draft of such notice before it is signed for gazetting.
- 7.3 In the absence of notice from the Minister, the IRF Legal and Technical Committee members are of the view that:

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- 7.3.1 the assets remaining in a living annuity may be paid as a lump sum to the original retiree member (or his beneficiary if the member is deceased) if the balance of that policy is less than R75,000 (or R50,000 if a prior, known commutation had occurred in relation to the funds in that policy);
- 7.3.2 there is no longer any requirement that a living annuity pays out for the lifetime of the member (and possibly the only limitation on the duration of a living annuity is the 5 year minimum period referred to in Regulation 54 of the Long-term Insurance Act in connection with annuities);
- 7.3.3 on the death of the original retiree member, the formula B tax table is to be applied (paragraph 3(ii) of the Second Schedule of the Income Tax Act deems the annuity to be a lump sum benefit);
8. GN16 is to be amended (in the light of the Taxation Laws Amendment Act, 2008 which introduced new limits for commutation of small annuities) and will specifically exclude any application to living annuities. SARS have undertaken to publish a draft of the revised GN16 for comment.
9. SARS had previously issued RF1/95 which detailed the "greater benefit" restrictions and reporting requirements. In the light of the surplus legislation and minimum benefits introduced into the Pension Funds Act, RF1/95 is no longer necessary and will be removed.
10. The Registrar of Pension Funds is likely to issue directives and/or circulars:
- 10.1 regarding the appointment of principal officers;
- 10.2 dealing with fee tariffs (excluding curators) and liquidator remuneration, as well as liquidations in general;
- 10.3 On enforcement (to replace Circular PF 108).
11. Schedule L of the regulations of the Pension Funds Act, which lists fees payable (for example on the submission of surplus apportionment schemes, applications in terms of section 15E for approval of the transfer from a reserve to an employer surplus account), has been signed and will be issued shortly.

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12. As part of its risk-based approach to regulatory supervision, the FSB has prepared a risk questionnaire which is to be circulated shortly for completion by each administrator registered with the FSB under section 13B of the Pension Funds Act.
  13. A draft board notice, dealing with requirements for the approval of administrators under section 13B of the Pension Funds Act, will shortly be published for comment.
  14. The tax treatment of payments may by way of deduction from individual minimum reserves or fund benefits pursuant to divorce orders, housing loans and maintenance orders was discussed. Until paragraph 9(3) of the Fourth Schedule of the Income Tax Act is amended (which is only likely to take place in 2010), a two-step process will continue to apply and funds still need to apply for two tax directives to deal with both the tax and "tax on tax" that is payable.
  15. The FSB is liaising with the authorities to have the retirement fund industry exempted from consumer protection legislation that is currently in draft form.
  16. Below is a draft article on the impact of divorce orders on retirement funds. The article was prepared by Jenny Gordon, a member of the IRF Legal and Technical Committee and has been amended with input from other members of the committee.

Samantha Davidson

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## **PENSION INTERESTS ON DIVORCE – THE LAW AS AT 8 JANUARY 2009.**

The Financial Services Laws General Amendment Act of 2008 (the Act) has been promulgated and the effective date for the sections, which deal with funds making payment of divorce awards, is 1 November 2008.

The Revenue Laws Amendment Act of 2008 was published in the Government Gazette of 8 January 2009 with various effective dates for the various provisions. This Act introduces a number of changes to the tax laws governing pension interests on Divorce.

### **Brief historical context**

You will recall that since 1989, a fund member's pension interest, as defined in the Divorce Act, was deemed to be part of his/her assets on divorce and could be taken into account when determining the asset distribution of the parties. A court is entitled to award a non-member spouse a portion of the pension interest. However this was unable to be paid out to the non-member spouse until a benefit accrued to the member under the rules of that fund, such as on termination of service, death or retirement of the member. Funds were merely ordered to endorse their fund records and to pay the non-member spouse the award when benefits accrued to the member.

With effect from 13 September 2007 the Pensions Fund Act was amended to allow retirement funds to pay the non-member spouse the award on divorce. The award to the member was deemed to accrue on date of divorce. However, the legislation was widely, although not exclusively, interpreted by most lawyers and funds to apply only to divorces concluded on or after that date and not to divorce awards made prior to 13 September 2007. The Pensions Fund Adjudicator held a contrary view but, in the main, funds adopted the more conservative view and asked non-member spouses to wait until the legislation was unambiguously amended, which was expected in the near future.

Many taxation aspects also required amendment and clarification in order to accommodate the changes.

### **1 November 2008**

The Act extends the clean break principle to affected divorces concluded prior to 13 September 2007.

With effect from this date, funds governed by the Pension Funds Act are able to make early payment of all valid divorce orders, which instruct the fund to make payment of a percentage or portion of the member's pension interest, as it was at date of divorce, to a non-member spouse.

### **The Legislation**

The sections introduced in the Act deviate from the provisions of the 13 September 2007 sections in a number of respects. The law is paraphrased as follows and applies to all divorce awards, which funds are ordered to pay and not just to pre 13 September 2007 orders.

1. Section 37D (a) allows a fund to deduct a divorce award (and Maintenance orders) from the minimum individual reserve or from the member's benefit immediately following the divorce.
2. The fund may only deduct a Divorce award (and Maintenance order) after the amount of the pension interest has been reduced by any prior loan or loan guarantee amount.
3. If a Maintenance order and a Divorce order must be deducted simultaneously, the Maintenance order is given preference in the hierarchy of payments.

### **Section 37D(4)(a)**

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4. The portion of the pension interest assigned to the non-member spouse in an order handed down after 13 September 2007 is deemed (for all purposes other than tax) to accrue to the member on:-
    - the date of divorce; and
    - on written submission of the court order by the non-member spouse by the pension funds named in the decree or the funds to which it has been transferred.
  5. An award assigned to a non-member spouse in terms of a decree of divorce or dissolution of a customary marriage granted prior to 13 September 2007 is for the purposes of any law (except the Income Tax Act) deemed to have accrued to the member on 13 September 2007 and must be paid in line with the rest of the section.

**Comment:** The legislation does not clearly state whether the divorce order needs to be served on the fund after the date of the legislation or whether it is sufficient for the divorce order to have been served at an earlier date, usually at around the time of the divorce. In respect of pre 13 September 2007 claims, in order to achieve administrative certainty, funds might want to ask for a copy of the court order to be furnished to the fund at the same time as the non-member spouse claims payment of the award. In respect of post 13 September 2007 orders, the same approach is recommended where the non-member spouse has not yet claimed. It needs to be borne in mind that it is the non-member spouse's duty to initiate the claim process. The fund will not attend to this of its own accord.

6. The fund must deduct the award on the date an election is made by the non-member spouse to have the award transferred to her directly or whether it should be transferred to another retirement fund.

**Comment:** At the time the non-member provides the fund with the order of court and asks for the award to be paid, she must indicate whether she elects it to be paid in cash to her or transferred to another fund. She must supply details of the fund or payment details to enable the fund to give effect to the order failing which the fund may retain the money.

7. If an election is made the fund must transfer or pay the amount within 60 days.
8. If no election is made the fund must ask the non-member to make an election within 45 days of receiving the court order. The non-member spouse must respond within 120 days.
9. If no response the fund must pay it directly to the non-member spouse within 30 days after the 120 days.
10. The non-member spouse is entitled to fund return from the expiry of the 120 day period until date of payment.
11. In a retirement annuity fund, despite the definition in the Divorce Act, the amount of simple interest in the calculation of the pension interest in a divorce award, which is defined by reference, as contributions plus 15,5% simple interest, may never exceed the fund return.
12. Despite the definition of Pension Interest in the Divorce Act, which is interpreted as being inapplicable to preservation funds, the benefits of a member in a preservation fund can, in terms of the Act, be assigned to a non-member spouse in a divorce order and given effect to by the preservation fund.

**Comment:** The applicable provisions of the Divorce Act were enacted prior to the introduction of preservation funds into the retirement arena. Hence they are ignored. Although an amendment should preferably have been made in the Divorce Act, the intention in this Act is for the interest of a member in a preservation fund approved under the Income Tax Act, to be calculated the same way as it would be, had the member been withdrawing from an occupational pension fund.

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(A non-member spouse may also transfer an award to a Preservation fund where the rules have been amended to accommodate this.)

### ***The Taxation***

Prior to the introduction of the clean break principle, the non-member spouse was only able to receive payment of the award when benefits accrued to the member. A tax court ruling in the 1990's held that despite the delay in payment, the non-member spouse's award no longer accrued to the member spouse, it vested in the non-member spouse.

So, if the amount no longer accrued to the member, it would mean that the member had no liability for tax on the amount. In order to avoid this, a provision was introduced into the Income Tax Act (paragraph 2B of the Second Schedule). It deemed the non-member spouse's award to accrue to the member, at the same time as the pension interest of which it forms part, accrues to the member. It made the member the taxpayer. This ensured that SARS could recover its tax from the fund at the same time as benefits accrued to the member. The legislation provided the member with a right to recover the tax from the non-member spouse personally. This is a right, which is often difficult to enforce.

When the clean break principle was introduced on 13 September 2007, the legislation needed to be amended to allow the award to be taxed at a date earlier than the date on which "the pension interest of which the award formed part" accrued to the member.

In the Revenue Laws Amendment Act of 2007 (effective date 8 January 2008)  
A new Paragraph 2(b) was introduced.

- Paragraph 2(b) included in the gross income of the member;
- Any lump sum amount deducted from the minimum individual reserve of the member under the particular divorce sub-section of section 37D (That sub-section of section 37D deemed the award and the tax to accrue to the member on date of divorce);
- The lump sum was deemed to be a lump sum benefit received by or accrued to the member from any pension, provident or retirement annuity fund;
- The lump sum accrued for tax purposes on the date of the deduction from the minimum individual reserve whereafter it could be paid over to another fund or paid to the non-member spouse in cash. (even though for the purposes of the Pension Funds Act it was deemed to accrue on the date of the divorce);
- It provided for the tax to be recovered by the member from the non-member spouse.

Paragraph 2B of the Second Schedule, which previously taxed the award when the benefit accrued to the member, was retained. It applies in cases where paragraph 2(b) does not. ( It is not entirely clear when paragraph 2(b) will not apply and 2B will.)

### **PRESERVATION BY THE NON-MEMBER SPOUSE IN ANOTHER APPROVED FUND**

The member pays tax on the award paid to the non-member spouse. If the non-member spouse chooses to transfer it to another fund, it is "after tax" money which is moving across. However, without legislation exempting it, when the non-member exits from the transferee fund, any lump sum would be taxed under the Second Schedule provisions.

Therefore symbol "E" in Formula "B" of the Second Schedule was also amended in that Act. Symbol "E" now recognizes that any amount which a non-member spouse elects to transfer to another approved fund will be tax-free when that person retires from the transferee fund or dies, if the benefit was taxed in the transferor fund.

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The same exemption was included in paragraph 6 of the Second Schedule in the later Taxation Laws Amendment Act of 2008 (effective date 23 July 2008). This allows the same tax-free status to the elected transfer on withdrawal from the transferee fund

All the above is applicable with effect from 13 September 2007 to 1 March 2009.

#### Tax on Tax

The fund pays the tax from the minimum individual reserve of the member. This unfortunately constitutes an additional deemed accrual of benefits to the member, which itself creates an additional liability for tax. Therefore tax on the tax must also be paid. SARS has provided a practice note in this regard, which is draft GN 33.

This practice note provides for the fund to apply for two tax directives. It first applies for a directive on the award. Thereafter it applies for a tax directive for the additional tax.

The legislation does not provide for the tax on tax to be recoverable from the non-member spouse.

Example:

Minimum individual reserve: R3million.

Award: R1million

Average rate: 30%

First directive tax on R1 Million: R300 000

Tax plus on tax:  $R300\,000 / 70\% = R428\,571$

Second directive: Tax on tax =  $R428\,571 - R300\,000 = R128\,571$

#### **A change to the taxation of Divorce awards**

In the budget review earlier this year, the intention to transfer the incidence of tax from the member to the non-member spouse in the future was indicated. This intention has now become law in the Revenue Laws Amendment Act but it does not apply across the board and care must be taken when applying it to divorce orders.

#### **TAXATION PRIOR TO 1 MARCH 2009.**

There are two types of divorce orders. Those concluded pre 13 September 2007 and those concluded after.

#### **Orders between 13 September 2007 and 1 March 2009**

In the current year of assessment, a divorce order award, which is payable under section 37D(4)(a) of the Pensions Fund Act, to the non-member spouse, will be deemed to accrue to the member on the date it is deducted from the minimum individual reserve. This is taxable under paragraph 2(b)(i).

The non-member spouse will be paid the amount stipulated in the court order. The tax will be paid by the fund from the member's remaining minimum individual reserve. ( But see later, this applies for a limited time)

Currently tax is paid at the member's average rate of tax.

#### **Pre 13 September 2007 orders processed on or after 8 January 2009**

There is a drafting mistake in the Revenue laws Amendment Act of 2008.

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Although paragraph 2(b)(i) which taxes the member spouse still exists until 28 February 2009, the Revenue Laws Amendment Act of 2008 introduced a new section which applies specifically to Pre 13 September 2007 orders with effect from 1 November 2008.

The section is reproduced as follows:

“(4) If a **person** is awarded an amount in terms of an order of divorce granted before 13 September 2007, that amount shall be deemed to have accrued to **that person** on the date on which **that person makes an election** contemplated in section 37D(4)(b)(ii) of the Pension Funds Act, 1956 (Act No. 24 of 1956) or on the date the amount is payable in terms of section 37D(4)(b)(iv) of that Act, to the extent that the amount is payable by a pension fund, pension preservation fund, provident fund, provident preservation fund or retirement annuity fund.”

On a reading of this section, the tax liability falls on the non-member spouse if the divorce order was granted pre 13 September 2007. However the explanatory memorandum to the Bill clearly states that the intention of the section is to still tax the member on pre 13 September divorces. The intention is not for the non-member spouse to become the taxpayer at all on pre 13 September 2007 divorces at all. Although, this drafting inconsistency was noticed at “Bill” stage and pointed out, the drafting error was not removed. Therefore funds are again in a position of uncertainty regarding pre 13 September 2007 orders. However, it is understood that the intention is to correct this mistake retrospectively in the first Revenue Bill of 2009, and the first draft is expected on 18 February 2009. Therefore funds may want to await the first draft of this Bill prior to processing pre 13 September orders.

Changes with effect from 1 March 2009

**1. Divorces which are concluded on or after 1 March 2009 which are deemed to accrue to the member and are deducted by the fund**

The non-member spouse will bear the tax. The new withdrawal tax table will apply. There will be no tax on tax liability because the tax will be deducted from the non-member spouse’s benefit.

**2. Pre 13 September 2007 awards which are deemed to accrue and which are deducted by the fund**

As mentioned above, the intention is to still tax the member spouse despite the mistake in the legislation, which should be corrected in the first Revenue Bill of 2009. With effect from 1 March 2009, the new withdrawal tax table will apply. Tax on tax will still apply.

**3. Divorces awards commencing 13 September 2007 until 28 February 2009, which are deemed to accrue and which are deducted by the fund.**

The wording of the legislation currently taxes the award on the date it is payable by the fund.

If the award is “deducted” ( previous wording) prior to 1 March 2009, the member will remain the taxpayer and the award will be taxed at the member’s average rate of tax. Tax on tax will apply.

If the award is payable by the fund after 1 March 2009 and therefore it is deemed to accrue in next year of assessment, the non- member spouse will become the taxpayer, regardless of the fact that the divorce occurred prior to 1 March 2009.

**Health Warning:** IT is an unusual situation for the taxpayer to change depending on the date the claim is processed. Attorneys drawing agreements prior to March 2009 need to understand this intended provision in the law and draw their divorce agreements accordingly. For existing agreements, a non-member spouse may find herself to be the taxpayer if she delays in claiming and serving the court order on the fund. The tax will then be deducted from her award. A fund

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must deduct the award on the date of the election. If the non-member spouse claims and elects payment at the same time, that will be the date of the deduction and therefore the accrual. By doing this she can attempt to ensure that the accrual date remains in the tax year prior to 1 March 2009, wherein the member is still the taxpayer.

### **Transfer to another fund after 1 March 2009**

There is a way in which the non-member spouse will be able to avoid paying tax immediately. If the non-member spouse elects to preserve and transfer the divorce award to another approved fund, the award will be transferred tax free to the transferee fund. (in terms of an amendment to paragraph 6). When the member leaves the transferee fund on withdrawal, retirement or death, the normal tax provisions will apply then. For example on death or retirement, the R300 000 tax free provisions in formula B will be applicable, if it has not been used in the past, and the graduated tax table will apply.

### **The GEPF**

The GEPF is not subject to the Pensions Fund Act and at date of writing, non-member spouses who have noted divorce orders on that fund will still not be able to extract their award until benefits actually accrue to the member in terms of the fund rules.

#### **Comment:**

It is unfortunate that until the Revenue Laws Bill of 2009 emerges, the situation regarding pre 13 September 2007 orders remains in limbo. Thereafter funds will need to decide whether to act on the intention or whether to await the final legislation.

### **Financial Planning issues**

The extension of the clean break principle to all pre 13 September 2007 awards highlights the retirement planning issues which need to be addressed by both parties.

The member will have a notable decrease in retirement benefits, which will be exacerbated by the tax payable as well as market conditions. It is essential for the member to take financial advice to ensure that he takes remedial action to ensure that his retirement planning is not compromised.

The non-member spouse is being provided with an opportunity to springboard her retirement plan at time when portfolio assets offer great value in relation to future growth potential. The non-member spouse should attempt to avoid spending this capital on transient luxuries.

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