

**REPORT TO MEMBERS OF THE PENSION LAWYERS
ASSOCIATION ON THE MEETING OF THE INSTITUTE OF
RETIREMENT FUNDS (IRF) LEGAL AND TECHNICAL
COMMITTEE HELD ON 13 & 14 OCTOBER 2010**

This note contains an update on various issues, both tax and regulatory. These issues are being discussed with the industry and the authorities and the IRF legal and technical committee is actively taking part in those discussions.

1. Amendments to the Pension Funds Act and the Regulations

The IRF asked the FSB about their progress on the amendments to the Act and the Regulations. This is expected by the second quarter of 2011.

2. Consumer Protection Legislation

It was noted that the effective date of the Consumer Protection Act has now been deferred until 31 March 2011 in terms of a Government Gazette notice.

3. Administrator risk assessments and section 13B requirements

The FSB advised that a work group is still in progress regarding the determination of the capital adequacy and liquidity requirements.

4. FSB work group: review of the liquidator remuneration (revision of BN74 of 2001)

The submission that was requested by the FSB in this regard has been sent and the FSB advised that a meeting with Wilma Makupo regarding increasing liquidation fees is to be held.

5. Draft note on service level commitment

The FSB advised that a rewrite of PF81 is currently underway and will be issued together with the service level commitment. The FSB could not provide a time line as to when this will happen.

6. Valuation exemptions

In the report-back note following the last L&T Committee meeting held on 21 and 22 July 2010, the FSB advised that their intention was to submit a formal response before this L&T Committee meeting regarding practical issues surrounding the effective date of section 14 transfers involving valuation exempt funds. No response was received but the FSB advised at this meeting that a draft response had been prepared in which the FSB's view on the matter is set out. The FSB advised that they are looking at revising Regulation 2, but there is no clarity as to when the draft will be issued. The FSB indicated that its recommendation is that funds should apply for valuation exemption at the expiry of the fund's second financial year-end, which although is at an earlier date than necessary, the application has to be at the expiry of a year-end because the fund's financial statements are needed. Because there is a gap between a fund's year-end and the finalisation of its financial statements, practically it makes sense for the fund to apply earlier, i.e. after the expiry of the fund's second financial year-end.

7. King III Report

A Draft Code for Responsible Investing by Institutional Investors in South Africa has been issued by the Committee on Responsible Investing. This Committee consists of a number of industry representatives, including Mervin King. This draft code is to be considered by the IRF Investment Committee.

8. FSB requirements for umbrella funds

The L&T Committee discussed the fact that it was uncomfortable about the umbrella fund definition being placed in the FSB board notice relating to valuations because it felt that this was very much through the back door. The FSB advised that the definition of umbrella fund is to be removed from this board notice and is to be dealt with in Regulation 30.

9. **Section 37C**

There are two separate work groups dealing with two issues that fall under section 37C. The first working group is dealing with general amendments to section 37C, which is a longer term issue. The second work group is dealing with the issue of living annuities and the death of a retiring member after exit, which is a more immediate issue. The Committee requested the FSB's confirmation of whether Circular 2 would be withdrawn in light of the submission made to the FSB. In the absence of Alta Marais at the meeting, this will be referred to her to respond.

10. **New Regulation 28: Draft for discussion**

The FSB confirmed that the next version of Regulation 28 is to be published at the end of October 2010 and the comment period will be until the end of December 2010.

11. **Transfers between preservation funds**

A submission was made by the IRF to the FSB on 2 August 2010 regarding two issues concerning transfers between preservation funds.

The first issue is whether section 14 applies to preservation fund to unclaimed benefits fund transfers. The second issue relates to whether section 14 is applicable to the situation where a preservation fund's rules provide for a withdrawal benefit by means of a transfer to another fund. The FSB advised that they are presently working on a response which has not yet been finalised, but they would attempt to finalise and circulate the response by the end of October 2010.

12. **Section 8 appointment of a Principal Officer, duties to report irregularities and termination of appointment**

The FSB advised that the final version of the Regulations will be issued in October 2010.

13. Unpaid Contributions by employers

The FSB advised that it is now willing to refer cases to the Enforcement Committee on condition that the board of the fund has taken sufficient steps before referring the matter to the FSB. Upon question as to what will be considered sufficient steps, the FSB advised that they have not agreed anything on this issue. It appears therefore that the referrals will be considered on a case by case basis. SARS indicated that it would also like to be informed about employers who deduct member contributions and do not pay these over to the funds as the IRP5's issued by SARS are therefore incorrect and SARS would want to know about this. If this is put in place, it may be useful to advise employers about non-compliance being reported to SARS as this may act as a deterrent to errant/non-compliant employers.

14. Electronic submissions on behalf of self-administered funds

It was raised with the FSB that electronic submissions are currently not possible because only section 13B license holders are listed as administrators and if the fund is the employer of the employees who do the administration of the fund, there is no section 13B license. The FSB advised that Lorraine De Swart could be contacted by self-administered funds and would assist with their electronic submissions.

15. Pensioner Benefit Statements

It was raised that the FSB had, on the basis of PF Circular 90, requested some funds to provide full benefit statements to pensioners every six months. The L&T Committee work group that has been set up with FSB representatives to re-look at PF Circulars 86 and 90 will take this issue into account and address this with the FSB as part of their work.

16. Different treatment of living annuities

This issue relates to the difference between a fund paying a living annuity and a living annuity that is payable by an insurance company. On death, a fund must apply section 37C but an insurance company does not have to. There is a conflict between the definition of a living annuity in the Income Tax Act and section 37C of the Pension Funds Act. The consequence is that if the living annuity is

purchased, the nominee elected by the annuitant must be paid the benefit by the insurance company, whereas in terms of section 37C a discretion is afforded to the trustees and the member has no control over the final decision as to how the benefit is allocated. This has also raised the question whether the nomination of a trust, including an *inter vivos* discretionary trust, as a beneficiary of a member owned living annuity is permitted in law. This situation has also resulted in people becoming aware that if they purchase a living annuity from an insurer they can control who that benefit goes to on their death in contrast to the trustees of the fund making this decision in terms of section 37C. The L&T Committee is to submit a note to the FSB/SARS on these issues.

17. FSB conference

The FSB advised that a trustee conference is to be held on 17 November 2010. Only trustees are allowed to attend and the conference will aimed at general governance issues.

18. Registrar's Annual Newsletter

This is to be published in November 2010.

19. Levy Structures

The FSB requested the IRF to propose members for a work group to review levy structures, including levies for administrators.

20. Change of Administration

The FSB advised that administrators must inform the FSB of any change in administration and from next year there will be harsh enforcement in this regard.

SARS ISSUES

21. Living Annuities

It was raised with SARS that there is industry uncertainty regarding the definition of a living annuity and the meaning of the word "nominee" and that some life companies are adopting a strict interpretation insisting that a nominee must be a

natural person, whereas other companies are less strict and have accepted that a trust can be nominated. This has resulted in people “company shopping” depending on whether the company will or will not recognise a trust being nominated. SARS advised that this issue has come to their attention and is under consideration. SARS also requested the FSB’s view on this, which will be directed to Alta Marais at the FSB. SARS felt that the FSB should take the lead in the thinking about this issue. The L&T Committee will make a submission to the FSB and SARS.

The issue of combining living annuities was raised with SARS because requests are being made to insurance companies by clients to consolidate and combine various annuities with one service provider. SARS indicated that there is no objection to this in principle, but the practical difficulty is how to apply the draw-down percentages to the combined capital amount in the first year (i.e. the year in which the annuities are combined). SARS advised that a new method would have to be found to value the underlying capital and it would consider an IRF submission in this regard, which must set out the scenarios and make suggestions as to how the merged annuities should be dealt with going forward.

The L&T Committee considered an issue regarding annuity draw-down rates, which has been raised by ASISA following a survey that was conducted in which life companies indicated that there is some support for one additional draw-down in order to introduce some product flexibility. It was mooted whether this should apply to so-called “hard luck cases” and whether there should be some form of regulation in this regard. It was also debated that if this allowed, “hard luck cases” are likely to be manufactured. This issue is to be referred back to ASISA as an annuity product issue.

22. Surplus payments and GN29

A draft submission regarding GN29 has been prepared by the L&T Committee and will undergo some minor changes before being submitted to SARS.

SARS advised that the new SARS note is due for circulation in February 2011.

A submission was made to SARS regarding paragraph 2B and the inequity that still exists regarding pre-13 September 2007 divorce awards. As the Taxation Laws Amendment Bill does not deal with this issue, it was raised again with SARS,

who advised that, because that it had not been dealt with in the latest amendments, it should not be assumed that it was off the SARS agenda. From SARS's point of view it is just a question of time and space and so it may still be dealt with in upcoming amendments.

23. GN35 and unclaimed benefits

The structure of an unclaimed benefits fund in relation to tax processes was raised. SARS was asked whether it considered an unclaimed benefits fund to be a new fund or a continuation of the previous fund when it accepts the unclaimed benefit. The difference is relevant in terms of the process of applying for tax directives because if the unclaimed benefits fund is considered to be a continuation of the previous fund, the administrator of the unclaimed benefits fund must carry all the historical information required to apply for a tax directive. The industry's view seems to be that an unclaimed benefit fund is not a continuation of the previous fund because the definition of a preservation fund supports the argument that an unclaimed benefit is a new benefit which is housed by the unclaimed benefits fund and because a section 14 transfer is not required when an unclaimed benefit is transferred to an unclaimed benefits fund. SARS advised that it has always understood it to be a new fund that received an unclaimed benefit. The IRF is to make a submission in this regard to obtain confirmation that this is how it is to be treated by SARS.

This is important from the aspect of agreement on what minimum benefit transfer information must be held by an unclaimed benefits fund and the process in respect of applying for tax directives.

24. Preservation Funds

Three issues were raised – the treatment of deductions; split-transfers; and the fate of RF1/98.

SARS advised that as there are still some "old" preservation fund in existence. The date for submission for approval under the new definition has been extended, so this is one reason why RF1/98 should be kept alive i.e. until the rules of the "old" preservation funds have been approved in terms of the new definition.

SARS advised that it had asked National Treasury for input and had received policy guidance in broad terms. National Treasury indicated that SARS should continue to apply its discretionary powers to prevent split-transfers from taking place and dealing with deduction issues. It appears that National Treasury is hesitant to write anything into law at this stage because of the social security and national health developments, so SARS has confirmed that it will continue to operate on a discretionary basis.

25. RA's and Emigration

It was raised whether the questions concerning accessing funds in an RA Fund can be applied to preservation funds if a once-off withdrawal has been taken. The submission concerning RA's and emigration has been made to National Treasury already and SARS advised that in principle the inclusion of preservation funds as well could be considered.

26. Tax Guide

The date for the circulation of the first draft is 30 September 2011 and the final publication date has been set as 31 January 2012.

27. Taxation Laws Amendment Act

SARS responded to the issue of section 10(1)(x) more particularly severance not being dealt with in the Taxation Laws Amendment Bill. SARS advised that, in their view, the distinction between voluntary and involuntary retrenchment is that voluntary retrenchments are as seen as part and parcel of an employer's whole retrenchment exercise, in other words, if employees are given the opportunity to accept voluntary retrenchment first and this is not successful then involuntary retrenchments occur. This is seen as part of section 10(1)(x) on the basis that a voluntary retrenchment is seen as phase of the full retrenchment exercise and it is dealt with on this basis. Therefore, if it is not part of a large retrenchment program then the tax treatment will differ.

28. Approval of foreign fund transfers

A list of outstanding approvals was submitted to SARS, which were approved altogether on a once-off basis. Since this occurred in July 2010, further approval submissions have not been dealt with. SARS advised that it would look into this.

29. Retrospective Approval of Rules

It is an industry problem that rule amendments having a retrospective effective date are not being approved by SARS. SARS has indicated that this will be addressed on a case by case basis. This is particularly a problem in relation to revised rules or rule amendments pertaining to surplus issues, for example, where fund accounts are created in the rules to deal with surplus but are back-dated to the valuation date. SARS advised that the general principle is that rules or rule amendments are not approved if retrospective, but if the effective date is one or two years back it is not a problem. SARS advised that it does not have authority to approve rules that are even one month retrospectively effective, but they do so in order to facilitate the practical issues.

30. Section 37D deductions in favour of third parties

If a member is considered by SARS to be a person who does not have his or her tax affairs in order, then housing loans and payments to third parties, e.g. the employer, cannot be done because a tax directive cannot be obtained. A suggestion to this was made that tax in terms of the GN35 be levied or something similar to this. SARS advised that they have no objection to this in principle and that it will be taken under consideration.

31. Re-opening of de-registered funds: The payment of outstanding benefits-SARS once-off approval for a limited period

This situation has arisen in respect of bulking settlements and payment of outstanding benefits where the FSB has agreed to reinstate the registration of a fund for a limited period. During this period benefits are paid tax free and then the fund is de-registered again. It was requested whether, from a SARS perspective, it would reinstate the approval of the fund. SARS advised that in principle there is no objection to doing this, but technically it did not know on what legal basis this is to be done. The Act only allows for cancellation of

registration and not for the cancellation of a de-registration. SARS pointed out that there may be problems because the accruals for tax purposes may have occurred a number of years ago when the benefit should have been paid out and the implications need to be considered if de-registrations are cancelled. The IRF is going to draft a submission to SARS in which all such issues are addressed.

32. Cancellation of tax directives by SARS if applied for an error

SARS was requested to confirm its position in light of a letter that was addressed to ASISA which indicated that SARS would not cancel directives in any circumstances. The concern is whether SARS intends to stop cancelling directives on any basis in the future. It is understood that the SARS system should not be abused by tax directives being applied for “fishing” purposes, but if there is an obvious mistake then this is different. SARS confirmed that it is still the position that tax directives could be cancelled if mistakenly applied for.

33. Schedule of notes to be redrafted

SARS has prepared a schedule of GN notes and RF practice notes to be reviewed/redrafted indicating the dates for circulation and final publication. This schedule, which was presented to the L&T Committee by SARS is copied below for information purpose: -

A	General/Retirement Fund Notes	Reason/s for reviewing/redrafting	submission Date – 1 st Draft – solicit comments from stakeholders	Due date for submission of comments	Date for 2 nd Draft after receiving comments from stakeholders	Projected date of Publication Date
1	RF 1/98	The introduction of the definitions of provident preservation and pension preservation funds in the Income Tax Act.	30 .11.2010	31.01.2011	28.02.2011	31.03.2011

2	GN 29	Legislative developments on the taxation of surplus distributions	31.01.2011	28.02.2011	31.03.2011	30.04.2011
3	GN 18	To align the contents with changes in the legislative framework specifically in relation to commutation of small annuities.	28.02.2011	31.03.2011	30.04.2011	31.05.2011
4	GN 35	To align the contents with the amended paragraph 4(1) of the Second Schedule to the Act	31.03.2011	30.04.2011	31.05.2011	30.06.2011
5	GN 33	Legislative developments on the taxation of divorce awards	30.04.2011	31.05.2011	30.06.2011	31.07.2011
6	GN 37	Legislative developments relating to maintenance awards	31.05.2011	30.06.2011	31.07.2011	31.08.2011
7	GN 30	Pertinent issues raised by stakeholders with regard to housing loans	30.06.2011	31.07.2011	31.08.2011	30.09.2011
8	GN 19	To provide clarity with regard to the purchase of more than one annuity at retirement in view of phasing out SITE.	31.07.2011	31.08.2011	30.09.2011	31.10.2011
B	GUIDE	Reason/s				
1	Comprehensive SARS	Comprehensive guide to enable members of	30.09.2011	31.10.2011	30.11.2011	31.01.2012

	Guide	retirement funds to know more about the taxation aspects relating to their benefits.				
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Should you have any queries relating to this note, please feel free to contact Vanessa Bell via e-mail on vbell@mortlaw.net.