



WORKSHOP 7

Provident fund annuitization

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13 May 2021

PENSION  LAWYERS
ASSOCIATION



AGENDA

1. Provident fund annuitisation- A decade in the making
2. Section 75 of the Taxation Laws Amendment Act, 23 of 2020 ('TLAA 2020')
3. Principles of 'provident fund annuitisation'
4. Industry Interpretations
 - Interpretations clarified by National Treasury/SARS
 - Interpretations still unresolved
5. Annexure C submissions not addressed by National Treasury ('NT')
6. Conclusion

RETIREMENT REFORM

1. Retirement fund reform initiatives were announced in Budget 2011
2. Provident fund 'annuitisation' forms part of a number of retirement fund reform initiatives:
 - Standardisation of tax deductibility of retirement fund contributions
 - Increase in the *de minimis* threshold retirement fund commutations
 - Allowing the transfer of retirement benefits after 'reaching normal retirement age'
 - Increased tax-free portability between retirement funds
3. Implementation of 'annuitisation' was deferred repeatedly
4. The Taxation Laws Amendment Act, 23 of 2020 ('TLAA') promulgated on 20 January 2021
5. The 'annuitisation' provisions contained in section 75 of the TLAA
7. Effective date of 1 March 2021

SECTION 75 OF THE TLAA

Sub-sections 75(a), (b), (c), (d) and (e) of the TLAA amend the definitions, respectively of ‘**pension fund**’, ‘**pension preservation fund**’, ‘**provident fund**’, ‘**provident preservation fund**’ and ‘**retirement annuity fund**’.

Extract: Section 75(a)

Amendment to sub-item (ii)(dd) of the proviso to the definition of ‘**pension fund**’ in section 1 of the Income Tax Act (‘ITA’)

*(ii) that the **rules** of the fund provide—*

*(dd) that not more than one-third of the total value of the **retirement interest** may be commuted for a single payment, and that the remainder must be paid in the form of an annuity (including a living annuity) except where two-thirds of the total value does not exceed R165 000, where the employee is deceased or where the employee elects to transfer the retirement interest to a pension preservation fund or a retirement annuity fund:*

SECTION 75 OF THE TLAA

*Provided that in determining the value of the **retirement interest** an amount calculated as follows must not be taken into account—*

*(A) in the case of a person who was a member of a provident fund or provident preservation fund and who was **55 years of age or older** on 1 March 2021—*

- (AA) any **amount contributed to** a provident fund or transferred to a provident preservation fund prior to, on and after 1 March 2021 of which that person was a member on 1 March 2021*
- (BB) with the addition of any other amount credited to the member's individual account or minimum individual reserve of the provident fund or provident preservation fund prior to, on and after 1 March 2021; and*
- (CC) any fund return, as defined in the Pension Funds Act, in relation to the contributions contemplated in item **(a)** or amounts credited contemplated in subitem **(b)**;*

SECTION 75 OF THE TLAA

(B) in any other case of a person who was a member of a provident fund or provident preservation fund on 1 March 2021—

- (AA) any amount contributed to a provident fund or transferred to a provident preservation fund prior to 1 March 2021;*
- (BB) with the addition of any other amount credited to the member's individual account or minimum individual reserve of the provident fund or provident preservation fund as a result of the value of the member's individual account or minimum individual reserve on 1 March 2021; and*
- (CC) any fund return, as defined in the Pension Funds Act, in relation to the contributions contemplated in item (AA) or amounts credited contemplated in subitem (BB),*

SECTION 75 OF THE TLAA

reduced proportionally by an amount permitted in terms of the Pension Funds Act to be deducted from the member's individual account or minimum individual reserve of the provident fund or provident preservation fund prior to, on and after 1 March 2021;

SECTION 75 OF THE TLAA

Some technical gaps

- There is no reference in the wording to how the benefits accumulated by a member of the original provident fund or provident preservation fund, as at 1 March 2021 have been transferred/accumulated in a transferee retirement fund.
- The fund credits and fund returns/growth only reference the benefits accumulated by a member of the original provident fund or provident preservation fund, as at 1 March 2021. The fund credits and fund returns/growth do not reference those same accumulated benefits in a transferee retirement fund.
- The proportional reduction of benefits only references the benefits accumulated by a member of the original provident fund or provident preservation fund, as at 1 March 2021 and not those same accumulated benefits in a transferee retirement fund.

ANNUITISATION PRINCIPLES

‘Purpose’ of provident fund annuitisation

The annuitisation of provident fund benefits (and indirectly the annuitisation of provident preservation fund benefits) from 1 March 2021 was introduced to **HARMONISE** the nature of the benefits payable from these funds at retirement with the nature of the benefits payable by pension funds, pension preservation funds and Retirement Annuities (‘RA’) at retirement.

NT has outlined its **‘policy intent’**, and in particular, the broad principles are outlined in NT’s Explanatory Memoranda, Response documents and workshop discussions.

As section 75 of the TLAA still has some technical gaps, a **“purposive approach”** has been adopted to the interpretation and implementation of the amendments so that fund rules, business and system changes, decisions by boards of trustees and expectations of fund members are aligned where possible, to NT’s policy intent.

ANNUITISATION PRINCIPLES

1. 'VESTED RIGHTS' vs 'VESTED BENEFITS'

- Provident fund and provident preservation fund members became members of these retirement funds with the EXPECTATION of receiving their benefits as cash lump sums at retirement.
- In order to secure their expectation, the legislative amendment grants them so-called '**vested rights**' to still take the benefits they have accumulated up to 1 March 2021 (plus fund returns/growth after 1 March 2021) as cash lump sums at retirement.
- Retirement fund benefits to which members have vested rights are commonly referred to as 'VESTED BENEFITS'. VESTED BENEFITS are retirement fund benefits subject to vested rights which can be commuted for a cash lump sum in full at retirement.
- Retirement fund benefits to which members do not have vested rights are commonly referred to as 'NON-VESTED BENEFITS'. These benefits are subject to annuitization i.e. up to 1/3 can be taken as a cash lump sum and the balance as an annuity. If the total value of the NON-VESTED BENEFITS is R247,500 or less, the full value of the NON-VESTED BENEFITS can also be commuted for a cash lump sum in full.

ANNUITISATION PRINCIPLES

2. Provident fund members YOUNGER than age 55 on 1 March 2021

- All the benefits they have accumulated in their provident fund up to 1 March 2021, PLUS amounts credited and fund returns/growth on those benefits after 1 March 2021 will comprise VESTED BENEFITS and can be taken as cash lumps sum at retirement.
- The contributions that these provident fund members make to their provident fund AFTER 1 March 2021, PLUS amounts credited and fund returns/growth on those contributions from 1 March 2021 however, will comprise NON-VESTED BENEFITS and will be subject to annuitisation.

ANNUITISATION PRINCIPLES

3. Provident fund members 55 or OLDER on 1 March 2021

- All the benefits these members have accumulated in their provident fund prior to 1 March 2021, PLUS amounts credited and fund returns/growth on those benefits thereafter will comprise VESTED BENEFITS. **In addition**, any contributions made to the provident fund from 1 March 2021 onwards, PLUS amounts credited and fund returns/growth on those contributions will all ALSO comprise VESTED BENEFITS that can be taken as cash lump sum at retirement.
- This means that all the benefits that these members accumulate in their original provident fund will comprise VESTED BENEFITS until retirement and will be able to take the full value of their retirement benefit as a cash lump sum. They will not be required to annuitise any portion of their benefits.
- If these members transfer to another retirement fund, the VESTED BENEFITS they have accumulated on transfer, plus amounts credited and fund returns/ growth on those benefits after 1 March 2021 will comprise VESTED BENEFITS. However, any contributions to that new transferee fund (together with amounts credited and fund returns/growth on those benefits) will comprise NON-VESTED BENEFITS.

ANNUITISATION PRINCIPLES

4. Provident preservation funds

- All the benefits members have accumulated in their provident preservation fund contracts up to 1 March 2021, PLUS amounts credited and fund returns / growth on those benefits after 1 March 2021 will comprise VESTED BENEFITS and can be taken as cash lump sums in full at retirement.
- Members of preservation funds can only transfer funds benefits into preservation funds. They cannot make “contributions” *per se*. This means that members of provident preservation who accumulated benefits in preservation fund contracts which were entered into prior to 1 March 2021 will only ever accumulate credits and fund returns/growth on those VESTED BENEFITS- not contributions. All their benefits in those existing provident preservation fund contracts will be regarded as VESTED BENEFITS- irrespective of their age on 1 March 2021.

ANNUITISATION PRINCIPLES

5. Transfers of VESTED and NON-VESTED BENEFITS

- VESTED BENEFITS and NON-VESTED BENEFITS that are transferred by a member of a provident fund or provident preservation fund to ANY OTHER RETIREMENT FUND after 1 March 2021 (excluding par (d) pension funds) will retain their VESTED and NON-VESTED nature in that new transferee retirement fund. This general rule is also true for any of those VESTED BENEFITS and NON-VESTED BENEFITS that may be transferred by that transferee fund to successive transferee retirement funds.
- VESTED and NON-VESTED BENEFITS (together with amounts credited/fund returns applied to them respectively) will retain their nature irrespective of how many times they are subsequently transferred to other transferee retirement funds and irrespective of the nature of retirement fund they are transferred to.

ANNUITISATION PRINCIPLES

6. Deductions in terms of section 37D of the Pension Funds Act

- Section 37D of the Pension Funds Act contemplates deductions such as, amounts due in respect of housing loans, pension interest awarded to spouses upon divorce, maintenance claims and compensation for damages to an employer.
- Amounts deducted from a retirement fund member's individual account or minimum individual reserve in terms of section 37D of the Pension Funds Act (after 1 March 2021) must be applied PROPORTIONATELY to VESTED BENEFITS and NON-VESTED BENEFITS.

INDUSTRY INTERPRETATIONS CLARIFIED BY NT

1. “Amounts contributed prior to 1 March 2021”

Sub-item (ii)(dd)(A)(AA) and (B) (AA) of the definition of ‘pension fund’ in the Income Tax Act (‘ITA’)

- The VESTED BENEFITS of provident fund members younger than age 55 include “*any amount contributed to a provident fundprior to 1 March 2021*”
- Section 13A(3)(a)(i) of the Pension Funds Act allows retirement fund administrators to collect retirement fund contributions in arrears, up to 7 days after the end of the month for which that contribution is payable.
- Industry has argued that contributions which were “**due and payable**’ up to the month of February 2021, but not yet collected by the fund administrator by that date should still form part of that member’s VESTED BENEFITS.
- In the Annexure C Workshop held on 4 December 2020 NT verbally confirmed that the existing wording of the legislation was sufficiently clear that amounts which were contributed in respect of payment periods prior to 1 March 2021 but only collected thereafter would still qualify as amounts contributed prior to 1 March 2021 i.e. they comprise VESTED BENEFITS.

INDUSTRY INTERPRETATIONS CLARIFIED BY NT

2. 'Gross contributions' vs 'net contributions'

Sub-item (ii)(dd)(A)(AA) and (B) (AA) of the definition of 'pension fund' in the Income Tax Act ('ITA')

- Included in a member's VESTED BENEFITS is "**any amount contributed** to a provident fund..." This wording does not specify whether the amounts 'contributed' to a provided fund are inclusive or exclusive of administration costs and risk premiums.
- Based on a normal reading of the wording, any "amount contributed" would include contributions inclusive of administration costs and risk premiums i.e. "gross contributions". However, adopting such an interpretation would mean that the value of VESTED BENEFITS would not align to the value of the investment savings in the retirement fund.

INDUSTRY INTERPRETATIONS CLARIFIED BY NT

- NT clarified in its Final Response Document dated 20 January 2021 that the policy intent is for the calculation of vested rights be based on “net contributions”. This clarification has been accepted and applied by the industry.
- NT’s Final Response Document date 20 January 2021

Comment: The current legislative wording seems to suggest that the calculation of vested rights is to be based on gross contributions (inclusive of all costs) as opposed to the net contribution (excluding all costs).

Response: Accepted. The policy intent that the calculation of vested rights be based on net contributions still remains. That said, the current wording in the 2020 Draft TLAB will be reviewed and if necessary, changes will be effected.

INDUSTRY INTERPRETATIONS UNRESOLVED

1. Approved Risk Benefits

Occupational fund rules often provide for approved capital disability benefits to apply to a member's share of fund in the event the member becomes disabled. Section 75 of TLAA does not specifically classify approved risk benefits credited to a member share of fund as either VESTED or NON-VESTED BENEFITS.

However, taking into consideration that approved risk benefits are amounts '*credited to a member's individual account or minimum individual reserve*' the industry is of the view that:

- In the case of provident fund members who were 55 or older on 1 March 2021 and still a member of the original provident fund, approved risk benefits credited to that member's individual account or minimum individual reserve AFTER 1 March 2021 will comprise 'VESTED BENEFITS'.
- In the case of provident fund members who were younger than age 55 on 1 March 2021, approved risk benefits credited to the individual account or minimum individual reserve AFTER 1 March 2021 will comprise 'NON-VESTED BENEFITS'.

INDUSTRY INTERPRETATION STILL UNRESOLVED

2. Partial pre-retirement withdrawals

Qualification to sub-items (ii)(dd)(A)(AA) and (B) (AA) of the definition of 'pension fund' in the Income Tax Act ('ITA')

- Partial pre-retirement withdrawals refer to the following:
 - A partial pre-retirement withdrawal taken from a pension fund or provident fund prior to the transfer of the balance of the benefits to a preservation fund or a new employer fund; or
 - A once-off partial pre-retirement withdrawal permitted to members of a pension preservation fund or provident preservation fund.
- Section 75 of the TLAA provides for proportional reduction of VESTED BENEFITS (and consequently NON-VESTED BENEFITS) of amounts “**permitted to be deducted in terms of the Pension Funds Act from a member’s individual account or minimum individual reserve**” of the provident fund or provident preservation fund prior to, on and after 1 March 2021.

INDUSTRY INTERPRETATIONS STILL UNRESOLVED

- NT's Final Response Document date 20 January 2021

Comment: The proposed amendment indicates that deductions (in terms of section 37D of the Pension Funds Act) from a member's benefit must, in all cases, first reduce vested rights. This is contradictory to what was stated in 2015 Response Document. Clarity is therefore sought as to whether the policy intent as communicated in the 2015 Response Document has since changed. Further to the above, the current legislative wording only caters for deductions from provident and provident preservation funds, and excludes any other retirement funds that said assets could be transferred to.

*Response: Accepted The policy intent as communicated in the 2015 Response Document still remains. That said, changes will be made in the 2020 Draft TLAB to indicate that deductions in terms of **section 37D of the Pension Funds Act** should proportionately reduce vested and non-vested rights. Amendments shall also be made to cater for instances where the assets are transferred from a provident or provident preservation fund into another retirement fund.*

INDUSTRY INTERPRETATIONS STILL UNRESOLVED

- NT and SARS are of the view that the words **“amounts permitted to be deducted in terms of the Pension Funds Act from a member’s individual account or minimum individual reserve”** only refers to deductions in terms of section 37D of the Pension Funds Act.
- Industry however has argued that the current wording **“amounts permitted to be deducted in terms of the Pension Funds Act from a member’s individual account or minimum individual reserve”** is wide enough to include deductions of partial pre-retirement withdrawals. Industry is therefore of the view that partial pre-retirement withdrawals should also be applied proportionately against vested and non-vested benefits.

INDUSTRY INTERPRETATIONS STILL UNRESOLVED

- The reasons for industry's views are outlined below:

Technical arguments

- The wording in section 75 of the TLAA is not specifically limited to permissible deductions in terms of section 37D. In terms of section 14B(1) of the Pension Funds Act, the formula to determine a member's individual account makes provision for *"amounts lawfully permitted, credited to or debited from the member's individual account"*. Partial pre-retirement withdrawals are therefore also permitted to be lawfully deducted from a member's individual account or minimum individual reserve *"in terms of the Pension Funds Act"*
- The definitions of pension preservation fund and provident preservation fund in the Pension Funds Act are the same definitions as those defined in section 1 of the Income Tax Act, 58 of 1962 ('the Income Tax Act). As the definitions of pension preservation fund and provident preservation fund in the Income Tax Act specifically allow for a pre-retirement withdrawal, such pre-retirement withdrawals are in fact permissible *"in terms of the Pension Funds Act"*.

INDUSTRY INTERPRETATIONS STILL UNRESOLVED

Parity arguments

- It is not logical for one type of deduction (such as a section 37D deduction) to reduce the VESTED and NON-VESTED BENEFITS proportionately, and another type of deduction (such as a partial pre-retirement withdrawal) to be applied on a different basis.
 - Applying a different basis to partial pre-retirement withdrawals may lead to inconsistencies in application and in some instances, absurd results.
- Industry is of the view that applying partial pre-retirement withdrawals on a proportional basis against VESTED and NON-VESTED BENEFITS is the most prudent and equitable way to apply the law.

INDUSTRY INTERPRETATIONS STILL UNRESOLVED

- NT and SARS are not aligned to the industry's interpretation.
- NT and SARS have considered the industry's views and have advised the industry not to apply partial pre-retirement withdrawals proportionately against VESTED and NON-VESTED BENEFITS.
- NT and SARS have unfortunately not confirmed how partial pre-retirement withdrawals should be applied i.e. whether they should be applied only to VESTED or only to NON-VESTED BENEFITS.
- In the absence of legislative certainty, industry members have no option but to apply their own interpretations of section 75 of the TLAA when applying partial pre-retirement withdrawal deductions against a member's VESTED and NON-VESTED BENEFITS.

1. Provident Fund members 55 and older on 1 March 2021, obligated to transfer benefits

Section 75 of the TLAA provides that all accumulated benefits of a provident fund member who is 55 or older on 1 March 2021 comprise 'VESTED BENEFITS'. This right not extended to the contributions and fund returns of such members in a transferee fund after 1 March 2021 i.e. those contributions and fund returns in the new fund will be NON-VESTED BENEFITS.

There are several instances in which a provident fund member is obliged to transfer his/her benefits to another retirement fund, for example:

- Where an employer consolidates retirement funds, and all the members are obliged to transfer their benefits to a transferee fund (or an umbrella fund) in terms of section 14; or
- Where employees are transferred from their existing employer to a new employer in terms of section 197 of the Labour Relations Act and are consequently obliged to transfer to a new retirement fund in terms of a section 14 transfer.

ANNEXURE C SUBMISSIONS NOT ADDRESSED

The industry is of the view that members of provident funds who are 55 or older on 1 March 2021 and who are obliged to transfer their benefits to a transferee retirement fund, should continue to accumulate VESTED BENEFITS in that transferee retirement fund i.e. their contributions to the transferee retirement fund, amounts credited on those contributions, and fund returns on those contributions should all be regarded as 'VESTED BENEFITS'.

Industry argues that NT policy encourages the consolidation of retirement funds. The policy intention which is extended to members aged 55 and over on 1 March 2021 and who are close to retirement should also apply to those same members who form part of a consolidation exercise. Those members should not be prejudiced as a consequence of such an exercise.

This industry proposal has not yet been addressed by NT.

2. 'Pension interest'

Section 75 of the TLAA provides for the proportional deduction of a member's pension interest awarded to a non-member spouse in terms of section 37D of the Pension Funds Act.

It does not, however make provision for the vested portion of that pension interest to retain its nature when that non-member spouse elects to preserve/transfer the pension interest to another retirement fund.

Industry has argued that the vested portion of the pension interest so transferred, should retain its nature as a "VESTED BENEFIT" in the transferee retirement fund of the non-member spouse .

This industry proposal has not yet been addressed by NT.



THANK YOU

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