Legal Report

August 2023

1. Draft Taxation Laws Amendment Bill, 2023

The Draft Taxation Laws Amendment Bill, 2023 has been published for public comment. The proposed amendments affecting retirement funds are as follows.

Limiting the retirement funds contribution deduction when a member ceases to be a tax resident

In terms of section 11F(2) of the Income Tax Act ("the Act") the total allowable deduction in respect of contributions to a retirement fund may not in a year of assessment exceed R350 000. When a member ceases to be a South African tax resident, there are two years of assessment during a single 12-month tax period. The first year of assessment is from 1 March until the date on which the member ceases to be a South African tax resident. The second year of assessment is from the date on which the member is a non-South African tax resident until the end of February of the following year.

As a result of a member having two years of assessment in a 12-month tax period when he/she ceases to be a South African tax resident, such a member is able to make a tax-free contribution of up to R700 000 during a 12-month tax period. This is because the R350 000 maximum applies per year of assessment and is not apportioned in instances where the year of assessment is less than 12 months. This is contrary to the policy rationale.

To address this anomaly, it is proposed that section 11F(2) of the Act be amended to stipulate that where a member's year of assessment is less than 12 months, the maximum allowable deduction of R350 000 is reduced proportionally.

The above amendment will come into operation on 1 March 2024 and apply in respect of years of assessment commencing on or after that date.

Clarifying the deductible employer contribution to a retirement fund

In terms of section 11F(4) of the Act, employer contributions to a retirement fund are taxable in the member's hands as a fringe benefit. Employer contributions are further deemed to have been contributed by the member, and the member accordingly has a deduction in respect of such contributions.

There is currently no requirement that the member only has a deduction in respect of employer contributions if the contributions have been included in the member's income. As a result, even if the employer contributions are not subject to fringe benefit tax because the member's remuneration qualifies for income tax exemption, the member may still be entitled to a deduction in terms of section 11F of the Act. If all the member's income is tax exempt, the employer contributions may further be carried forward to retirement or withdrawal and be allowed as a deduction against the member's lump sum or annuity, once again without the member having been taxed on such employer contributions.

The above is contrary to the policy intent. The policy intent is for a deduction or tax credit to only be afforded to amounts included in the taxpayer's income. A deduction or tax credit should not be available for tax exempt amounts.

To address this anomaly, it is proposed that section 11F(4) of the Act be amended to stipulate that the deduction in respect of employer contributions only applies to the extent that the contributions have been included in the member's income as a taxable benefit.
The above amendment will come into operation on 1 March 2024 and apply in respect of years of assessment commencing on or after that date.

Transfers of retirement fund members on or after normal retirement age

Paragraph (e) of the definition of "gross income" in the Act includes in the gross income of a person "*a retirement fund lump sum benefit*". "Retirement fund lump sum benefit" is defined as including "*an amount determined in terms of paragraph 2(1)(c) of the Second Schedule*".

Paragraph 2(1)(c) of the Second Schedule to the Act, referred to above, refers to "*any amount transferred for the benefit of that person on or after normal retirement age, as defined in the rules of the fund, but before retirement date, less any deductions permitted under the provisions of paragraph 6A*".

The combined effect of the above provisions is that any amount transferred for the benefit of a member on or after his/her normal retirement age forms part of his/her gross income unless it falls within the deductions provided for in terms of paragraph 6A of the Second Schedule. This is not limited to transfers in respect of members who have retired from employment, but includes transfers in respect of members who have not yet retired from employment, but who have reached normal retirement age.

Paragraph 6A, in respect of transfers on or after normal retirement age, only makes provision for a deduction in respect of a transfer from a pension fund and provident fund to a retirement annuity fund or preservation fund, and not to another pension fund or provident fund. The effect hereof is that when an active member who has reached the normal retirement age is transferred from a pension fund or provident fund to another pension fund or provident fund, the amount transferred is, based on the current wording of paragraphs 2(1)(c) and 6A, part of his/her gross income, and as such taxable.

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To address the above issue, it is proposed that paragraph 6A be amended to include, in respect of transfers on or after normal retirement age, a tax deduction in respect of transfers from a pension fund or provident fund to another pension fund or provident fund. This will ensure a tax-free transfer of members of a pension fund or provident fund who have reached the normal retirement age. The definitions of "pension fund" and "provident fund" will further be amended so that the value of the transferred retirement interest, including growth thereon, will remain ring-fenced and preserved in the receiving pension fund or provident fund until the member elects to retire from that fund. This means that the member will not be entitled to the payment of a withdrawal benefit in respect of the amount transferred and can only receive the transferred amount as a retirement benefit.

The above amendments will come into operation on 1 March 2024 and apply in respect of years of assessment commencing on or after that date.

2. Rule amendment may not be implemented before registration

The Constitutional Court has in the matter of *Mudau v Municipal Employees' Pension Fund and Others* confirmed that a retirement fund rule amendment is of no effect until such time as it has been registered, and that it may not be implemented pending registration thereof. The court in this regard said the following:

"*At the heart of the appeal is whether a fund may apply a rule amendment that is not yet registered in anticipation of its future registration and determine the payment of benefits due on that basis. It may not do so.*"

The court, in support of its decision, referred to the decision of the Supreme Court of Appeal in the matter of *Mostert N.O. v Old Mutual Life Assurance Co (SA) Ltd*, in which the court made it clear that although amended rules may have retrospective effect after registration, they do not have binding effect before registration.

3. Jurisdiction of Pension Funds Adjudicator

The Supreme Court of Appeal has in the matter of *Municipal Gratuity Fund v The Pension Funds Adjudicator and Another*, contrary to a decision of the Financial Services Tribunal in this regard, held that a complainant is not obliged to submit a complaint to the relevant fund before lodging a complaint with the Pension Funds Adjudicator.

The court in this regard, with reference to section 30A of the Pension Funds Act, said the following:

"*Ms Mutsila (the complainant) had an option under s 30A, bearing in mind that the legislature has changed the wording of ss 30A(1) of the Act. Previously, the section stipulated that a complainant 'shall' lodge a written complaint with a fund for consideration by its board before the matter may be referred to the Adjudicator. This indicated a peremptory requirement. The subsection was amended in 2007 to substitute the word 'shall' with 'may'.*"

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4. Section 37C of the Pension Funds Act not applicable to unclaimed benefits

The Financial Sector Conduct Authority (FSCA) has on 25 March 2020 published FSCA Interpretation Ruling 1 of 2020 (RF), which deals with the applicability of section 37C of the Pension Funds Act to paid-up members, deferred retirees and unclaimed benefits. According to this interpretation ruling, section 37C applies to paid-up members, deferred retirees and unclaimed benefits, where no election to withdraw has been made by the member prior to his/her death.

The FSCA has now issued a draft interpretation ruling, which is intended to replace FSCA Interpretation Ruling 1 of 2020 (RF). As mentioned above, section 37C of the Pension Funds Act according to the current interpretation ruling also applies to unclaimed benefits. It is stated in the Communication accompanying the draft interpretation ruling that this is a mistake, and that section 37C should in fact not apply to unclaimed benefits. The following is said in this regard:

"*The inclusion of members of an unclaimed benefit fund within the ambit of 37C was an error of law in that, by definition, an unclaimed benefit is an accrued benefit which has already become due and payable to the member and remains as such after it has been transferred to an unclaimed benefit fund. Therefore, the payment of an unclaimed benefit is not conditional upon the occurrence of another event, such as the death of the member. Accordingly, whilst a member of an unclaimed benefit fund is a member within the meaning of section 1 of the PF Act, an unclaimed benefit does not become payable as a result of the death of such a member, as contemplated in section 37C.*"

The new interpretation ruling will in essence confirm the interpretation as set out in the current interpretation ruling, except for the fact that it will confirm that section 37C of the Pension Funds Act does not apply to unclaimed benefits. The draft interpretation ruling is open for comment until 26 September 2023.

5. FSCA's Regulatory Framework Update

The Financial Sector Conduct Authority (FSCA) has in its August 2023 Regulatory Framework Update provided an update on the current status of various regulatory developments, whereunder the following:

- It is envisaged that the Joint Standard on outsourcing by insurers will be submitted to National Treasury during the third quarter of 2023 for it to be tabled in Parliament.

- With regard to the Conduct Standard on the conditions for living annuities forming part of a fund's annuity strategy, the FCSA is currently considering whether the assumptions used in the Standard are still appropriate given the time that has elapsed since the assumptions were developed. This might impact the timing of the issuing of the Standard and further information in this regard will be communicated in due course.

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- The Conduct Standard on the communication of benefit projections to members of retirement funds is being considered in the light of broader developments such as the transition to the Conduct of Financial Institutions Act. A final decision on when to proceed with this Standard must still be taken.

- With regard to the Prudential Standard on regulation 28 reporting requirements for retirement funds, it is likely that regulation 28 reporting in terms of this Standard will not commence in 2023 and that a live date of 2024 might be more practical. A final decision in this regard will be taken in due course.

- A need has been identified to proceed with the Conduct Standard on the requirements pertaining to retirement fund administrators. However, this will likely entail a watered-down version of the Conduct Standard that addresses the main risks but avoids potential misalignment with the future framework under development as far as possible. Next steps are still being considered, i.e. whether the Standard should be published for another round of public consultation or whether it can be submitted to Parliament.

6. New Trustee Training Toolkit

Section 7A(3) of the Pension Funds Act requires trustees of retirement funds to attain prescribed levels of skills and training within 6 months after being appointed or elected and to retain such prescribed levels throughout their term of appointment.

Conduct Standard 4 of 2020 prescribes the Trustee Training Toolkit as the official minimum training requirement for all trustees of retirement funds in South Africa. The Trustee Training Toolkit is a free e-learning programme which has been specifically developed to provide trustees with a better understanding of their roles and to assist them in performing their fiduciary duties more effectively and efficiently.

The Financial Sector Conduct Authority (FSCA) has been working on redesigning the Trustee Training Toolkit, and has issued a press release in which it says that it is gearing up to launch the newly revamped Trustee Training Toolkit. The first eleven modules of the platform will be launched in September 2023, with the other eleven modules being launched in 2024.

Trustees are notified in the press release that completing the new Trustee Training Toolkit will be compulsory. In the Frequently Asked Questions document accompanying the press release it is stated that the new Trustee Training Toolkit will not have a pass or fail outcome, and that the emphasis is on equipping trustees with the necessary knowledge and skills. The new Trustee Training Toolkit does however contain module assessments and a summative assessment.

Retirement funds or other clients requiring more information should not hesitate to contact their consultant.

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