Legal Report January 2020

Newsletter of Sanlam Corporate: Legal

1. Taxation Laws Amendment Act, 2019 ("TLAA")

The TLAA introduces the following relevant changes to the Income Tax Act, 1962 ("the Act") and the Estate Duty Act, 1955:

Aligning the effective date of tax neutral transfers between retirement funds with the effective date of all retirement reforms

Applicable provision: Par. 6(1)(a) of the Second Schedule to the Act

Background

The compulsory annuitisation requirement for provident funds and provident preservation funds was postponed a number of times over the last few years. Each postponement requires consequential amendments to the Act.

When the last postponement was effected, postponing the effective date to 1 March 2021, an oversight occurred in that the effective date of the part of the Act that provides for tax neutral transfers between all retirement funds, and in particular transfers from pension to provident funds or pension preservation to provident preservation funds, was not also postponed to 1 March 2021.

Amendment

The TLAA rectifies the oversight with (retrospective) effect from 1 March 2019, i.e. postpones the effective date of tax neutral transfers from pension and pension preservation funds to provident and provident preservation funds to 1 March 2021. The TLAA also rectifies an oversight in the Act to allow for a tax-free transfer from a provident preservation fund to a pension fund.

Exemption relating to annuities from a provident or provident preservation fund

Applicable provision: Section 10C of the Act

Background

A member's non-deductible contributions to a pension, provident or retirement annuity fund that have not been off-set against any lump sum received are allowed as an exemption when determining the taxable portion of annuities provided or purchased by a pension fund, pension preservation fund, retirement annuity fund or provident preservation fund upon retirement.

In the past, the exemption did not apply to annuities provided or purchased by a provident fund (in other words, non-deductible contributions can only be off-set against lump sums received from a provident fund).

Amendment

The TLAA seeks to extend the section 10C exemption to provident funds with effect from 1 March 2020.

Due to an apparent drafting error the exemption will however from 1 March 2020 only apply to provident and provident preservation funds, and not to any other fund. This will have to be corrected. A further problem is that, according to the TLAA, the exemption will only apply to an annuity paid directly by a provident fund or provident preservation fund, and not to an annuity purchased from an insurer. This would likewise seem to be due to a drafting error. Hopefully both these drafting errors will be corrected so that the amendment achieves what we believe should be its purpose, i.e. to extend the section 10C exemption (which currently applies in respect of all types of retirement funds other than provident funds) also to an annuity paid by a provident fund or an insurer from which the provident fund purchased an annuity.

Tax treatment of bulk payments to former members of closed funds

Applicable provision: New paragraph 2D of the Second Schedule to the Act

Background

Paragraph 2C of the Second Schedule provides, among others, that lump sum benefits payable after exit from a retirement fund, and as a result of an event as prescribed by the Minister of Finance, are tax exempt. In 2009 the Minister of Finance published a notice in the Government Gazette prescribing the events in terms of which certain extraordinary lump sum payments by a retirement fund qualify for an income tax exemption:

- Amounts paid in consequence of 'undisclosed secret profits' received by an administrator prior to 1 January 2008 and paid to the fund concerned;
- Amounts paid by a fund that is not required to register in terms of the Pension Funds Act, to the extent that the amounts are similar to a payment in terms of a surplus apportionment scheme contemplated in section 15B of the Pension Funds Act;
- Certain unclaimed benefits paid by a preservation fund to which these benefits were transferred.

The explanatory memorandum to the TLAA states that when the said notice was published, some retirement funds were no longer registered and the extraordinary lump sum payments are currently still held or controlled by the respective fund administrators. Since paragraph 2C, read with the notice, only makes provision for extraordinary lump sum payments made by registered active retirement funds, extraordinary lump sum payments made by fund administrators (on behalf of a fund that has already been deregistered) will not qualify for an income tax exemption.

Amendment

The TLAA extends the income tax exemption to extraordinary lump sums paid by fund administrators on behalf of deregistered funds, subject to criteria to be determined by the Minister in a revised notice. The amendment will apply from a date to be determined by the Minister of Finance by notice in the Government Gazette.

Reviewing the tax treatment of surviving spouse pensions

Applicable provision: Paragraph 2B of the Fourth Schedule to the Act

Background

The explanatory memorandum that accompanied the Taxation Laws Amendment Bill states that if a retirement fund member dies and a spouse's pension becomes payable by the fund to a surviving spouse who also receives a salary or other employment income, that salary or other income is added to the spouse's pension to determine his or her tax liability on assessment. The result of the assessment is generally that the surviving spouse has a tax liability that exceeds the employee's tax withheld by the employer and retirement fund concerned during the year of assessment, since the aggregation of income pushes him/her into a higher tax bracket.

According to the explanatory memorandum, this creates a cash flow burden and a tax debt for the surviving spouse. However, in public comments made in respect of the draft Taxation Laws Amendment Bill, it was pointed out that other individual taxpayers who receive remuneration from more than one source are also impacted.

According to the explanatory memorandum, in order to assist with alleviating the financial burden in this regard, the tax rebates applicable to the surviving spouse or any other taxpayer receiving income from a retirement fund(s) or insurer(s) are not to be taken into account by the retirement fund(s) or insurer(s) when calculating the taxes to be withheld on the spouse's pension or other pension. Any Pay-As-You-Earn (PAYE) excessively withheld will be refunded upon assessment.

Amendment

The explanatory memorandum states that retirement funds and insurers are, with effect from 1 March 2021, required to apply for an annual tax directive from the South African Revenue Service (SARS) - the directive will advise the fund or insurer whether or not the tax rebates should be disregarded when calculating the taxes due on amounts paid by it.

Despite this statement in the explanatory memorandum, the amendment only applies to pensions paid by a retirement fund and voluntary annuities purchased from an insurer. It does not apply to member-owned pensions paid by a long-term insurer outside the fund (GN 18 pensions).

Furthermore, although the explanatory memorandum states that retirement funds and insurers must approach SARS for an annual tax directive, the retirement fund industry is of the view that the wording of paragraph 2B does not place such an onus on retirement funds and insurers. Submissions have been made to National Treasury by various industry bodies in this regard.

It should be noted that SARS will have to apply the law as contained in the Act and would not be able to rely on wording contained in the explanatory memorandum. However, it is possible that the new provision could be amended before its implementation date, which is 1 March 2021. Industry bodies intend to arrange a meeting with National Treasury to discuss the various issues relating to paragraph 2B.

Definitions of provident fund and withdrawal interest

Applicable provision: section 1, sub-clause (b)(ii) of the definition of "provident fund" and the definition of "withdrawal interest" in the Act

Background

Currently, an employee who is a member of both a pension fund and a provident fund (a so-called hybrid fund) cannot elect to transfer his or her withdrawal benefit under the provident fund to the pension fund.

Amendment

The definition of 'provident fund' has been amended (with effect from 15 January 2020) to allow for an employee to elect to transfer his or her provident fund withdrawal interest to a pension fund established by the same employer or a pension fund in which the employer participates, subject to the fund rules. The definition of 'withdrawal interest' has also been amended (with effect from 1 March 2019) to determine its value on the date on which the member elects to withdraw due to an event other than the member attaining 'normal retirement age' as defined in the Act.

The effect of the amendment is that a member of a hybrid fund can, e.g. subsequent to resignation, transfer his/her withdrawal benefit under his/her provident fund to his/her pension fund, provided his/her withdrawal occurs before his/her normal retirement age, which in terms of the Act is the earliest date on which the member is entitled to retire in terms of the rules of the fund.

Contributions deductible at death: Asset for estate duty purposes

Applicable provision: Section 3(2)(bA) of the Estate Duty Act

Background

Section 3(2)(bA) of the Estate Duty Act was previously amended by the Taxation Laws Amendment Act of 2017 to include as a deemed asset in the estate of a deceased any contributions to a retirement fund that were not allowed as a deduction in terms of the provisions of the Income Tax Act. The purpose hereof was to prevent persons avoiding estate duty by making large contributions to a retirement fund in the year the person dies.

Amendment

Section 3(2)(bA) has been amended to no longer include as a deemed asset contributions to a retirement fund that were not allowed as a deduction, but to instead include as a deemed asset contributions to a retirement fund that were allowed as a deduction to determine the taxable portion of the lump sum benefit payable at the deceased's death. The amendment applies from 30 October 2019 in respect of the estate of a person who dies on or after that date, and in respect of contributions made on or after 1 March 2016.

2. FSCA Communication 7 OF 2019 (PFA): Principal Officers employed by service providers

The stated purpose of the Communication (issued on 12 December 2019) is to inform the industry and stakeholders about the FSCA's approach to addressing the alleged conflict of interest relating to principal officers appointed by boards of retirement funds while also being employed by service providers.

The Communication refers to Directive 8 (Prohibition on the Acceptance of Gratification) which was issued on 8 March 2018 and, among others, provides that certain types of gratification are automatically not permitted to be accepted, agreed or offered to be accepted by:

- a board member (trustee);
- a principal officer or deputy principal officer;
- an employee of a retirement fund;

- a valuator;
- an auditor;
- an administrator or employee of an administrator; or
- other or service provider to a fund, from:
    - any other person connected in whatsoever manner to a service provider of a fund; or
    - any potential future service providers,

in which such board member, principal officer, deputy principal officer, employee of a retirement fund, valuator, auditor, administrator, employee of an administrator or other officer or service provider to a fund or other officer serves.

Paragraph 4.1(a) of Directive 8 provides that any gratification which, objectively viewed, creates a conflict of interest with the fiduciary duty of the said persons towards the fund, is automatically prohibited. The Communication states that principal officers owe fiduciary duties to the funds concerned and, since a gratification is defined in Directive PF No. 8 as including "*any office, status, honour, employment, contract of employment or services, any agreement to give employment or render services in any capacity*", the FSCA concludes (in the Communication) that "*the simultaneous employment of the principal officer by a service provider is impermissible and is also undesirable*". The Communication also refers to paragraph 3.8.4 of Guidance Notice 2 of 2018, which states as follows:

"Where a retirement fund officer has an interest in a service provider to a retirement fund, and there are no circumstances that dictate that the retirement fund cannot reasonably appoint another service provider, this will constitute a breach of Directive 8. For example, the principal officer or trustee of a retirement fund may not also be a director or employee of the law firm appointed by the retirement fund for legal services. The reason is that this would create an avoidable conflict of interest."

The majority view in the retirement industry would seem to be that merely holding the position of principal officer of a fund in respect of which the employer of that principal officer is also a service provider, is not automatically a contravention of Directive 8. One of the reasons why the FSCA is of the view that principal officers owe fiduciary duties to the funds concerned is that, according to the Communication, *"The principal officer is also expected to provide guidance to the board on matters requiring the board's decision and for the execution of such decisions. This will include the guidance on the appointment or termination of service providers."* It should however be noted that the Pension Funds Act ("the Act") does not place these duties on the principal officer. In terms of the Act the board of trustees "*direct, control and oversee the operations of a fund*" and it would therefore seem that the board of trustees has all the decision-making powers relating to the affairs of the fund. It is also significant that the Act specifically states that the board has fiduciary duties to members and beneficiaries, while no such statement is made in respect of principal officers.

According to the Communication, the FSCA will be writing to those funds that have been identified (by the FSCA) "*to obtain an Enforceable Undertaking, in terms of section 151 of the Financial Sector Regulation Act, from the fund concerned and all relevant parties including the principal officer, to take remedial actions within a specified period in order to bring the fund into compliance*".

3. RDR documents published by FSCA

The FSCA has published the following six Retail Distribution Review (RDR) documents on its website:

1. Proposal TT Discussion Document (Savings and Investment for the low-income market) with feedback template - feedback is due 28 February 2020;
2. Adviser Categorisation Discussion Document with feedback template - feedback is due 31 March 2020;
3. 2nd Investments Related matters Discussion Document with two annexures - feedback is due 31 March 2020;
4. Equivalence of Reward Position Paper;
5. Intermediary Segmentation and related matters paper;
6. General RDR Status update document.

Below is a link to the six documents:

https://www.fsca.co.za/Regulatory%20Frameworks/Pages/Treating-customers-fairly.aspx

Sanlam will provide comments via industry bodies on the documents in respect of which comments have been invited, i.e. documents 1-3 above. Documents 4-6 above are not for comment.

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