Discovery

The effect of changes to the Taxation Laws Amendment Act No. 20 of 2022

The Taxation Laws Amendment Act No. 20 of 2022 ("TLAA") was promulgated in Government Gazette No. 47826 on 5 January 2023.

The TLAA includes the following changes relevant to retirement funds

- Allowing for partial transfers on retirement annuity funds
- Protecting the vested benefits of members of a provident fund on 1 March 2021 if that member transfers their benefit to a public sector fund
- Allowing a member of a provident fund to retire before age 55
- Allowing for the transfer of an in-fund living annuity to another fund.
- Clarifying that death benefits payable by a fund can be paid to an unclaimed benefit fund where there are no beneficiaries or an estate

Allowing for partial transfers on retirement annuity funds

Previously, retirement annuity fund members with more than one contract in a specific retirement annuity fund were restricted to transferring all the contracts from one retirement annuity fund to another. Members of retirement annuity funds were required to transfer 100% of their interest in that retirement annuity fund to the other fund. This restriction did not apply to members of preservation funds.

The annuitisation principles across all retirement funds, which came into effect on 1 March 2021, resulted in tax-free transfers between all funds. The definition of "***retirement annuity fund***" in the Income Tax Act ("ITA") ***allows a member of a retirement annuity fund to transfer their total interest in any approved retirement annuity fund into another approved retirement annuity fund***.

The implication of this is that a member with more than one policy in the same retirement annuity fund could not do a split-transfer. This created a problem where a member has taken out more than one contract in a specific retirement annuity fund and wants to transfer one or more (but not all) of those contracts to another retirement annuity fund.

National Treasury's primary reform policy has always been to align the tax treatment across all retirement funds and, seeing that split transfers were permitted on preservation funds, the tax legislation has now been aligned to allow for partial transfers from retirement annuity funds.

With effect from 1 March 2023, the definition of "***retirement annuity fund***" in the ITA has been amended to ***allow a member to transfer individual policies from a retirement annuity fund to another retirement annuity fund, subject to a*** **de minimis** ***amount of R371,250* applying to the contracts transferred as well as the remaining balance in the transferring retirement annuity fund***.
***Important**: the annuitisation *de minimis* of R247,500 does not apply on transfers; *de minimis* of R247,500 only applies on retirement from a fund.
The amended definition also makes it clear that the *de minimis* amount of R371,250 does not apply where a member transfers their total interest from one retirement annuity fund to another.

Applying the new rules on transfers

If a member has more than one contract in a retirement annuity fund, they may transfer one or more of those contracts to another retirement annuity fund, ***provided that the combined value of the contracts transferred is more than the*** **de minimis** ***amount of R371,250 and the combined value of the remaining contracts is also more than R371,250.*** *If the member transfers all their contracts from one retirement annuity fund to another, no* de minimis *rules will apply.*

Application of the **de minimis** ***rules*** **event**	***De minimis*** **amount**	**Implication**
Transfers between retirement annuity funds	R371,250	The value of the policies transferred must exceed R371,250 and the value of the remaining policies must also exceed R371,250.
Retirement annuity fund paid-up withdrawal	R15,000	If the total value of the member's paid-up benefit is less than R15,000, they can withdraw their benefit as a lump sum before age 55.
Retirement benefit commutation	R247,500	If the total retirement benefit of a member of a retirement fund is less than R247,500, they can take the full retirement benefit as a lump sum.
Living annuity commutation	R125,000	If the remaining value on a living annuity policy is less than R125,000, the annuitant can take that as a lump sum.

Impact on transfers between the Discovery RA funds

Discovery Invest has multiple retirement annuity (RA) products which form part of two different retirement annuity funds. These can be identified based on their investment number prefix as shown in the following table:

Discovery Investment Retirement Annuity Fund	**Discovery Life Retirement Annuity Fund**
856	882 (DRO) 857

The impact of the TLAA will be no different to any other transfer but be aware that the *de minimis* rules may affect the intended transfer.

For example, a client who has a paid-up Life RA and an active Life RA who wants to transfer the paid-up Life RA to an investment RA, this would be a transfer between two separate funds. The transfer is ***subject to the* de minimis *amount of R371,250 on the Life RA being transferred as well as the remaining Life RA.***

Protecting vested rights when transferring to a public sector fund

Provident fund members who were members of the provident fund on 1 March 2021 retain their vested rights if they transfer to another approved fund after that date. Retaining vested rights did not apply if provident fund members transferred to a public sector fund. However, the current provisions of the legislation would result in vested rights being forfeited if a transfer is made into a public sector fund due to the wording of the legislation.

From 1 March 2023, *the definitions of "**pension fund**" and "**provident fund**" in the ITA have been amended by adding a proviso that makes it clear that the vested benefits of provident fund and provident preservation fund members who transfer their benefits to a public sector fund will also remain protected*
Important: This change in legislation does not apply retrospectively so provident fund members who have already transferred to a public sector fund after 1 March 2021, but before 1 March 2023, will still be subject to the annuitisation rules on retirement.

Retirement of a provident fund member before age of 55 on grounds other than ill health

Following the annuitisation alignment that came into effect from 1 March 2021, all retirement fund members must use at least two-thirds of their retirement benefits to purchase an annuity. This amount subject to the *de minimis* rule and the protection of provident and provident preservation fund members' rights to take their vested benefits as a lump sum.

There is no minimum prescribed retirement age for pension or provident funds. The retirement date in these funds is the same as the retirement date imposed by the member's employer participating in the fund. In general, most of these funds' rules allow for a normal retirement age ranging from 60 to 65 years and early retirement from age 55. The earliest date on which a member of a preservation and retirement annuity fund can claim a retirement benefit from the fund is 55. There may be fund rules that allow for a retirement age of below 55 depending on the employment duties of employers (a fund set up for professional sport people, like rugby players whose retirement age is 35).

Paragraph 4(3) of the Second Schedule to the ITA currently requires the lump sum received by a member of a provident fund, who retires from that fund before the age of 55 on grounds other than ill health, to be taxed as a withdrawal benefit. If that person was a member of a pension fund and they retired before age 55, their lump-sum retirement benefit would have been taxed as a retirement benefit.

This differentiation in the tax treatment of retirement benefit lump sums is not justifiable in light of National Treasury's alignment of pension and provident funds, which resulted in the contributions and retirement benefits of members being treated in the same manner.

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Paragraph 4(3) of the Second Schedule to the ITA is deleted with effect from 1 March 2023

This implies that if provident fund rules allow for a retirement date earlier than 55, the lump-sum retirement benefit of a member of that fund will be taxed as a retirement benefit and will be subject to annuitisation rules.

Allowing for the transfer of an in-fund living annuity to another fund

The current definition of "*living annuity*" in the ITA allows for an annuity to be purchased or provided by the fund of which the annuitant was a member on their retirement date ("in-fund living annuities"). This can be interpreted to mean that an in-fund living annuity cannot be transferred to another fund. The literal interpretation of the definition could have an adverse effect on pension and provident funds wanting to transfer all or part of their assets and liabilities to another pension or provident fund.

For example, a participating employer in a free-standing retirement fund with in-fund living annuitants may want to transfer to an umbrella fund under section 14 of the Pension Funds Act. To enable the termination of the free-standing fund, the assets and liabilities of all its members (active and paid-up) and annuitants (retirees and death benefit beneficiaries) should be transferred to the umbrella fund. The interpretation of the definition of "*living annuity*" created a situation where occupational funds could only transfer active member benefits, with annuitants of in-fund living annuities remaining behind. This restriction stood in the way of funds closing after they have transferred to an umbrella fund and conflicted with National Treasury reform policy on consolidation of funds.

The Amendment substitutes the reference to "that fund" in the definition of "living annuity" in the ITA with "any fund". This means that the transferor fund will be able to transfer their in-fund living annuities to the transferee fund where:

- *A participating employer transfers from one pension or provident fund to another pension or provident fund*
  or
- *One pension fund or provident fund is transferred to another pension or provident fund in full.*

Clarifying that death benefits that a fund must pay can be paid to an unclaimed benefit fund where there are no beneficiaries or an estate

A fund must pay a benefit – or the remaining portion of it (if there was a nominated beneficiary for a portion of the benefit) – into the estate of the member if:

- A fund does not become aware of or cannot trace any dependant of a deceased member within 12 months of the death of the member
  and
- The member has not nominated, in writing to the fund, a beneficiary to receive a portion of the benefit.

This provision is from Section 37C of the Pension Funds Act.

If there is no estate, the benefit or unallocated death benefit, must be paid into either the Guardian's Fund or an unclaimed benefit fund. This applies to all retirement funds except beneficiary funds.

An unclaimed benefit fund is a preservation fund that is specifically created to accept unclaimed benefits, as defined in the Pension Funds Act, from retirement funds.

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The definition of "*unclaimed benefit*" in the Pension Funds Act does not specifically refer to an unallocated death benefit; it only refers to a benefit that became payable to a beneficiary but was then not paid within 24 months after the fund became aware of the member's death. This implies that the fund did find a beneficiary, allocated a portion of the death benefit to that beneficiary, but then did not pay the benefit within the 24 months.

Although the Pension Funds Act allows for an unallocated death benefit to be transferred to an unclaimed benefit fund, this is not allowed in terms of the ITA.

The definitions of "pension preservation fund" and "provident preservation fund" in the ITA have been amended by substituting '' 'unclaimed benefit' as defined in the Pension Funds Act" with ***'' 'unclaimed benefit' as defined in section 1 of the Pension Funds Act and as contemplated in section 37C(1)(c) of the said Act".***

This clarification aligns the legislation with industry practice (currently, funds transfer unallocated benefits to unclaimed benefit funds). The ITA still does not allow for the transfer of an unallocated death benefit from a retirement annuity fund to an unclaimed benefit fund. It also does not allow for the transfer of an unclaimed benefit as defined in the Pension Funds Act from a retirement annuity fund or a beneficiary fund to an unclaimed benefit fund.

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