

# What new tax rules mean for provident funds

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Retirement funds and their administrators are in for a busy time in the next few months. This is because the new tax rules regarding the annuitisation of provident funds will be coming into effect on 1 March 2021.



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The rules attempt to address the problem of retirees spending their retirement fund lump sums too quickly and the resulting risk of their outliving their retirement savings.

National Treasury first mooted the annuitisation rules in 2013 as part of the process of harmonising the tax treatment of the different kinds of retirement funds. Its proposals (known as ‘T-Day reforms’) were contained in the Taxation Laws Amendment Bill and were originally intended to come into effect on 1 March 2015.

However, there was such an outcry from some parts of South Africa that Government was trying to nationalise retirement funds, that the introduction of some of the proposed changes was delayed.

While the alignment of the tax treatment of contributions to retirement funds went ahead from 1 March 2016, the proposed annuitisation of provident funds was postponed.

Now, it appears that the annuitisation provisions will finally take effect. The Minister of Finance set the scene for this on 28 October 2020 by tabling the Taxation Laws Amendment Bill of 2020 (TLAB) which will, once promulgated, become the Taxation Laws Amendment Act (TLAA).



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### Similar rules for all on access to cash

In terms of the annuitisation rules in the TLAB, members of all pension, provident and retirement annuity funds will be subject to similar rules regarding access to cash on retirement.

From 1 March 2021, with specific exceptions provided in the 'grandfathering' provisions, members of a provident fund or a provident preservation fund will only be able to take one-third of the total value of their retirement fund interest as a lump sum, with the balance being taken as an annuity.

This does *not* apply to members whose total retirement interest does not exceed R247,500. They may take the full amount in cash.

Furthermore, the restriction on lump sum withdrawals will only apply to amounts contributed to provident or provident preservation funds on or after 1 March 2021 and not to members who are close to retirement.

This means the annuitisation rules will *not* apply to:

- the credit in the fund as at 1 March 2021 and subsequent fund return on that amount; or
- members of provident funds and provident preservation funds aged 55 years or older on 1 March 2021 who will be entitled to take their full benefits on retirement (including fund return thereon), as well as any contributions made to the provident fund after 1 March 2021.

These changes mean that provident funds and their administrators will need to keep accurate member records indicating the pre-March 2021 contributions and fund return, and post-March 2021 contributions and fund return.

### Still more changes to come

Meanwhile, further legislative changes are in the pipeline for the retirement fund industry.

On 29 September 2020, the Conduct of Financial Institutions (CoFI) Bill was published for public comment, containing significant proposed changes to the Pension Funds Act, 1956.

These include renaming the Pension Funds Act as the 'Retirement Funds Act' and adding a definition of 'provident fund'; however, the proposed definition does not align with the TLAB provisions as far as they relate to annuitisation. We assume that this was an oversight and that the definition of 'provident fund' will be corrected when the final CoFI Bill is published.

After a six-year hiatus in terms of retirement fund legislation, change is happening thick and fast. Retirement funds and administrators have their work cut out for them in keeping up.



## Implications

Retirement funds would need to have their rules amended to align with the annuitisation provisions. The Income Tax Act, 1962 (ITA) provides that the Commissioner may approve a fund as 'pension fund' or 'provident fund' or 'provident preservation fund', as the case may be, provided that the *rules* of those funds comply with certain conditions.

In relation to a provident fund, for example, one of the (current) conditions is that rules of the fund provide that the total value of a member's retirement fund interest may be taken as a lump sum benefit.

When the annuitisation provision comes into effect and for the purpose of ensuring that the fund complies with the conditions, the rules of a provident or provident preservation fund would need to be amended to provide that not more than one-third of the total value of the retirement interest may be commuted as a single lump sum, with the balance taken as an annuity, subject to the grandfathering rules referred to above.

An immediate question that comes to mind is whether a provident fund, for example, will retain its approval in terms of the ITA if its rules do not comply with the new annuitisation provisions by 1 March 2021.

Retirement funds are required to submit rule amendments to the Financial Sector Conduct Authority (FSCA) for approval.

Another question, then, is whether funds will be entitled to submit rule amendments to the FSCA before 1 March 2021 or whether funds should first wait for the TLAA to be promulgated before submitting rule amendments to the FSCA.

Substantial changes to a TLAB are not expected as a general rule, but this risk cannot be excluded.

If a similar timeline is followed as in previous years, the TLAA should be promulgated in the second half of January. This leaves provident and provident preservation funds and their administrators with a very tight timeline to draft their rule amendments and submit it to the FSCA for approval.

Funds impacted by the proposed amendments are thus urged to commence with this process without any delay.

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