



## Legal & Policy Division

### Retirement Funds Section

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The Chief Executive Officer  
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Dear Madam,

### **INCOME TAX: RETRENCHMENTS AND ACCESS TO BENEFITS IN A RETIREMENT ANNUITY PRIOR TO AGE 55**

I refer to your letter dated 10 May 2010.

Please note that this is a non-binding private opinion based on my understanding of the facts submitted in support of your request for my views as well as your suggested solutions to the issues raised.

#### **Current Legislation**

In terms of the current tax legislative framework, paragraph (b)(v) of the definition of *Retirement Annuity Fund* (RAF) (in section 1 of the Income Tax Act (the Act)) alludes to a situation where the member normally sustains or reinstates his or her contributions until he or she reaches retirement date in terms of the rules of the fund.

Sub-paragraphs (x) (aa); (bb), (cc) and (dd) of paragraph (b) of the same definition must, on the other hand, be read together. They actually reinforce the provisions of the above-mentioned paragraph (b)(v). Their collective essence is that any paid-up benefit is payable to the member *only* when he or she reaches his or her retirement date in terms of the rules of that fund *unless* the member *discontinues* his or her contributions in one of the circumstances alluded to in sub-paragraphs:

- (b)(x)(bb) (i.e. where his/her total value in the fund is less than R7 000); or
- (b)(x)(cc) (i.e. where such a member is emigrating from the Republic),

in which event a *withdrawal benefit* is payable by a RAF.

With reference to the tax treatment of *withdrawal benefits* that are paid by employer funds in consequence of or following upon redundancies or

retrenchments, the Explanatory Memorandum to the Taxation Laws Amendment Bill of 2009 states that:

“If taxpayers are involuntarily retrenched, it is accepted that money may have to be *withdrawn* from *employment retirement savings funds...*”. Withdrawals following job losses will therefore benefit from the retirement table and the R300 000 exemption”.

The above-quoted text from the Explanatory Memorandum means that the R300 000 tax deduction is limited to a *withdrawal benefit* from an occupational fund in circumstances where the exit from the latter is triggered by retrenchment or redundancy *only*. Since an employer/employee relationship is one of the *eligibility for membership* conditions of an employee’s membership of an occupational fund, it is acceptable that an employee’s membership of an employer fund comes to an end when the particular employment relationship is terminated.

A RAF, on the other hand, does not have an employer/employee relationship requirement which means that the termination of the employment of a member of a RAF does not normally have an impact on such a member’s continued membership of the RAF.

In context, the receipt or accrual of the *lump sum benefit* (referred to in sub-items (AA) and (BB) of paragraph 2(1)(a)(ii) of the Second Schedule to the Act), is linked and limited to the termination of employment through redundancy or retrenchment.

Whereas I agree with your assertion that “...*it was not the intention to give members of retirement annuity funds access to their retirement benefits, prior to age 55 ...*”, I must point out that paragraph (b)(x)(aa) of the definition of RAF has specifically been inserted to provide clarity that a member who discontinues his or her contributions prior to his or her retirement date in terms of the rules of that fund, can only access his or her benefit *from the date on which he or she would have become entitled to the payment of an annuity if he had continued with his or her contributions*. This means therefore, that the benefit can only be accessed on the member’s retirement date from that RAF, notwithstanding the premature discontinuance of the contributions to such a fund.

In light of all of the above, it is not clear to me why the IRF seems to be inferring or implying that sub-items (AA) and (BB) under paragraph 2(1)(a)(ii) of the Second Schedule to the Act, could be read to signify an intention by the legislature to create an automatic link between retrenchment from employment and the withdrawal of a member’s benefit from a RAF on a basis other than those alluded to in sub-paragraphs (b)(x)(bb) and (b)(x)(cc) of the definition of RAF.

In my view, therefore, it is neither required nor necessary that:

- paragraph (b)(x)(aa) of the definition of RAF be deleted.
- paragraph (b)(v) of the definition of RAF be deleted or that paragraph (b)(x)(aa) be amended to read as suggested in your letter or in any way different from how it currently reads.

- *the rules of a fund allow a member who is retrenched automatic access to his retirement interest in a retirement annuity fund.*
- *Treasury should also specify whether a member can take the whole amount as a lump sum or whether the 1/3, 2/3 rule that applies on retirement will apply.*

### **Concluding Comment**

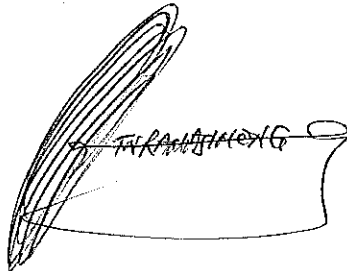
For all intents and purposes of the rules of a fund, a benefit that is paid by an employer fund in consequence of or following upon redundancy or retrenchment (of an employee who is a member of such a fund) is a *withdrawal benefit*. It is normally paid in the form of a lump sum. The one-third/two-thirds requirement is not applicable in the circumstances.

It is only for purposes of the (Income Tax) Act that such a benefit is accorded a tax deduction that is normally available on a lump sum benefit that is paid either on death in service or retirement, whichever is earlier in respect of a member.

The tax concession of R300 000 on this *withdrawal benefit* was introduced to alleviate financial hardship on employees retrenched as a result of the global recession experienced at the time. It was however, not intended to change the character of the benefit as a *withdrawal benefit* as determined in the rules of an employer fund, neither was there an intention to create additional circumstances under which a *withdrawal benefit* becomes payable by a RAF.

I trust that you will find the above information helpful.

Sincerely

A handwritten signature in black ink, appearing to read 'T. Ramasimong', is written over a white rectangular stamp or box. The signature is somewhat stylized and overlaps the stamp.

**T. Ramasimong**  
**for COMMISSIONER FOR THE SOUTH AFRICAN REVENUE SERVICE**