A law regulating taxation of pension benefits in South Africa

BY

Vusi Oscar Segodi

[redacted]

LLB (UL)

A mini dissertation submitted in fulfilment of the requirements for the degree of Masters of Laws (LLM) in Labour Law in the School of Law, Faculty of Management & Law, University of Limpopo (Turfloop Campus).

Supervisor: Adv. LT Nevondwe

March, 2015

TABLE OF CONTENTS

ABSTRACT

This mini-dissertation discusses the legal reform of the taxation of pension benefits under the South African law. This study also discusses how South African pension benefits are taxed in instances wherein the member exits the fund either as a result of resignation, death, dismissal, retrenchment, disability and retirement. It further discusses the comparative study between South Africa, Canada, Australia and United Kingdom

DECLARATION BY SUPERVISOR

I, **Adv. Lufuno Tokyo Nevondwe**, hereby declare that this mini-dissertation by **Vusi Oscar Segodi** for the degree of Masters of Laws (LLM) in Labour Law be accepted for examination.

………………………………………..

Adv. Lufuno Tokyo Nevondwe
March, 2015

DECLARATION BY STUDENT

I, **Vusi Oscar Segodi**, declare that this mini-dissertation hereby submitted to the University of Limpopo, for the degree of Masters of Laws (LLM) in Labour Law, has not been previously submitted by me for a degree at this or any other university, that it is my own work in design and in execution and that all material contained herein has been duly acknowledged.

…………………………………..

Mr Vusi Oscar Segodi

March, 2015

DEDICATION

I dedicate this work to my wife, children and members of the family who also stood by me in the compilation of this mini-dissertation.

ACKNOWLEDGEMENTS

My work was made easier by the following persons:

- My Supervisor Adv. Nevondwe who lectured me the basic principle of pension law, benefits, retirement, retrenchment, dismissal, disability and resignation.
-

I wish to acknowledged Mrs Mahlodi Sethole through her encouragement to pursue this mini-dissertation .Lastly to my wife and children in helping out to type and produce this work eligibly i.e. Cornelia (wife), children- Kgao, Reabetswe and Mpendulo.

LIST OF ABBREVIATIONS

RLWB	Retirement Fund Lump Sum Withdrawal Benefits
CCP	Canada Pension Plan
RLB	Retirement Fund Lump Sum Benefit
PFA	Pension Funds Act
GEPF	Government Employees Pension Fund
PAYE	Pay as you earn
RRSP	Registered Retirement Savings Plan
PPS	Personal Pension Scheme
PPP	Personal Pension Plan
UK	United Kingdom
SARS	South African Revenue Services
NT	National Treasury
SASSA	South African Social Security Agency

TABLE OF CASES

1. *Robinson v Central Retirement Annuity Fund [2001] 10 BPLR 2623 (PFA).*
2. *Karam v Amrel Provident Fund [2003] 9 BPLR 4260 (PFA).*
3. *Dobie NO v National Technikon Retirement Pension Fund [1999] 9 BPLR 29 (PFA).*
4. *NR v ER and Another 2012 (2) SA 481 (GSJ).*
5. *De Kock v Jacobson and Another 1999 (4) SA 346(W).*
6. *Mthiyane v Fedsure Life Assurance Ltd and Others (2) [2002] 5 BPLR 3460 (PFA).*

TABLE OF STATUTES

1. Pension Fund Act, 24 of 1956
2. Income Tax Act, 58 of 1962
3. Divorce Act, 70 of 1979
4. *Canadian Government Annuities Act, 1908*
5. Canada Pension Plan Board act, 1997
6. Finance Act, 2004

CHAPTER ONE: INTRODUCTION

1.1. Historical background to the study

Modern pension funds owe their existence largely to the industrial revolution and the social and technological advances that have since taken place. Although pensions had been paid in one form or another for hundreds of years prior to these advances, particularly in Europe,[1] employees tended to work throughout their lives, and in infirmity were cared for by their extended family unit or by the local community.[2]

The industrial revolution saw a major change in the nature of society and the start of mass urbanization. Industrial employers took over the role of work and sustenance provider, and the village and family unit was gradually broken down. As time went on, employers needed to strive for business efficiency and productivity which led to a shorter effective working life, and it was not too long before the more socially conscious employers recognized a need to make provision for those employees who had given them good service but had become too old to keep up with the physical pressures of work in a factory. Later, as competition among employers for skilled employees became a factor, those socially conscious employers who were known to provide some form of provision for their retired employees were able to attract better and more qualified employees, so the provision of basic pensions began to expand as a means of attracting and retaining good employees. [3]

---

[1] For example, retiring generals were often given gifts of land or cash by way of payment for loyal service, and the servants of landed gentry were often rewarded in a similar fashion when they were no longer able to carry out their duties effectively.
[2] Jeram N, Introduction to South African Pension Law manual, office of the Pension Funds Adjudicator, p4.
[3] Jeram N, *ibid* at page 4.

In the early days, development in South Africa tended to follow that in the United Kingdom. Pensions were initially paid out of current earnings, but as their coverage widened and they were increasingly demanded by long-serving skilled employees, prudent employers started to look for ways of pre-funding these expectations. It is interesting to note that the internationally recognized normal retirement age of 65 was first introduced in Germany.[4]

Around the early 1920's, governments also saw the advantage of encouraging more formal arrangements as society became more dependent on savings made during employment as a means of survival in old age, rather than reliance on the family or community unit. They also realized, however, that some form of control over how pensions were being provided was necessary, and so, with the introduction of tax incentives to encourage the growth of savings for old age, they used their respective tax legislation to establish rules regulating pension benefits. This resulted in a rapid increase in the number of employers providing properly funded and secure pension benefits.[5]

Funds were set up either as private arrangements where the employer employed his own staff to manage the fund and invest its assets, or alternatively employers often purchased life insurance policies in the names of individual employees, and in that way removed the risk of the pension not being available should something untoward happen to the employer. Group insured arrangements, where one master policy was issued to provide the benefits for all the employees of an employer were only introduced in the early 1950's.

---

[4] Statistics at the time indicated that the average life-span of a male worker was 66 years. The benevolent Germans decided, therefore, that all male employees (very few women worked full-time in those days, if at all) would retire on reaching age 65 so that they had one year remaining to enjoy themselves and put their personal affairs in order, before they died. Therefore, the cost of providing pensions was relatively low as those few who actually retired rarely survived much longer.

[5] Jeram N, Introduction to South African Pension Law manual, office of the Pension Funds Adjudicator, p4.

In 1956, the South African Government introduced what is generally recognized to be the world's first ever Pension Funds Act[6] ("the Act") designed specifically to regulate the business of pension funds.[7]

The late 1950's and the 1960's saw incredible economic growth among First World countries, and with it the emergence of giant multinational corporations employing thousands of people. The growth in pension funds during this period, and the improvement in the benefits they provided, mirrored this increase in employment and prosperity.

Since then, with the incredible advances in information technology and the growth of available investment vehicles, including the opening of international investment channels, pension funds have become highly sophisticated. This has led to a proliferation of new types of funds, including umbrella funds administered by professional sponsors and open to voluntary participation by any employer, on behalf of its employees, and preservation funds which cater for the "parking" of the retirement funding assets of individual members until they retire or decide to transfer them to another fund.[8]

Currently, society world-wide, is on the move again, and employment patterns are changing even more rapidly. Naturally, with changes in social patterns and working conditions come changes in retirement provision, and it is likely that we will see the effects of these changes sooner rather than later in pension funds. We may even find that the pension fund spawned by the industrial revolution gives way to something quite different, and is discarded into the history books.

[6] Act 24 of 1956.
[7] At that time, and for several years thereafter, other countries relied mainly on trust law and various other legal principles, including, of course, the very powerful conditions imposed in their income tax acts.
[8] Jeram N, Introduction to South African Pension Law manual, office of the Pension Funds Adjudicator, p4.

Meantime, attempts are being made by the South African Government, among others, to catch up with current social change and the ever increasing demands of consumer protection and good governance, by re-writing the Act in terms of today's needs for tomorrow's society.[9]

Retirement is a consequence of the industrialization and therefore a creation of modern society. Before industrialization people worked until they had to stop working as a result of old age or illness. Funds were set up either as private arrangements where the employer employed his own staff to manage the fund and invest its assets or alternatively employers often purchased life insurance policies in the name of individual employees and in that way removed the risk of the pension not being available should something happen to the employer.[10]

The Pension Funds Act[11] defines a pension fund as any association of persons established with the objects of providing annuities of lump sum payment of members or former members of such associations upon reaching their retirement dates or for the dependents of such members or former members upon the death of such member or former member. The earliest record of pension provision in South Africa is in the 1837 when the pensions were paid by the British to some of their military staff. In 1956, South Africa was the first country to have comprehensive legislation to regulate retirement funds.[12]

---

[9] See National Treasury *Retirement Fund Reform – a discussion paper* December 2004.

[10] See Ramabulana M, Pension Law seminar, University of Limpopo Legal Aid Clinic, presented by the Office of the Pension Funds Adjudicator,09 June 2006, University of Limpopo (Turfloop Campus).

[11] Act 24 of 1956.

[12]George DT, Analysis of South African pension fund conversations: 1980-2006; Developing a model for dealing with environmental changes, PHD, UNISA, 2006.

Pension funds are the most widely used retirement planning tool, mainly because of the tax concessions applicable to pension funds and their members.[13] Section 37A (1) of the Pension Funds Act[14] prohibits the alienation of pension benefits in any form whatsoever. The Act[15] provides that a registration fund may deduct from a benefit which becomes due to a member or beneficiary, in terms of the rules, any amount due by the member in terms of the income tax.[16]

1.2. Statement of the research

The major problem with the pension fund is, initially the pension fund was to help close the gap between poverty relief measure and tax-incentivized long-term insurance and encourage savings measures that do not provide adequately for low-income or irregular income workers.

A number of inequities and complexities which need to be addressed in the tax system have been identified at the same time the tax system needs to maintain sufficient incentives in place to encourage voluntary additional provision for retirement, particularly as the requirements and the cost of regulatory compliance by retirement funds is higher than the requirement and cost of such compliance by other savings vehicles.[17]

---

[13] Metz R, *Paying less tax made simple*, 2008, p147.
[14] Act 24 of 1956.
[15] Section 37A(1)(a).
[16] Act 58 of 1962.
[17] Choma HJ and Nevondwe LT, *Socio-Economic Right and financial planning in South Africa* , First edition, 2010, David Publishing Company, USA, p 282.

The current system of taxation of pension is discouraging savings to provide for the replacement of income on retirements, disablement or death, It therefore discourages the poor from saving during their working age in that, the little that they save will not be enough to replace income on retirement and on the other hand make them fail the means test thus disqualifying them to receive the old age grant, by implication, they will be too rich to qualify for the government grant, yet too poor for self-sustainability. It discourages preservation of pension benefits.

According to the diagnosis of the capacity approach, 'poor governance' (see World Bank)[18] is the result of an over-extended state relative to its institutional capacity at a given moment in time. The analysis of governance crucially assumes that inherited capacity constraints and that this constraint is what should orient the shape of administrative, institutional and policy reform. The policy advice, therefore, for poorly performing economies generally advocates reducing the state's role in resource allocation decisions.[19]

1.3. Literature review

According to Nevondwe pension funds are the most widely used retirement planning tool, mainly because of the tax concessions applicable to pension funds and their members. Section 37A(1) of the Pension Funds Act prohibits the

[18] According to the World Bank (1997: 41-60), the five 'fundamentals' that lie at the core of good governance for a state are: a) establishing a foundation of law, b) maintaining a non-distortionary policy environment, including macroeconomic stability, c) investing in basic social services and infrastructure, d) protecting the vulnerable and e) protecting the environment. While tax is not explicitly mentioned as a core function of governance, tax capacity is implicitly behind items [c] and d

[19] Jonathan D, *The political economy of taxation and tax reform in developing countries*, Research Paper, no 2006/74

alienation of pension benefits in any form whatsoever. However, section 37D(1)(*a*) of the Pension Funds Act provides that a registered fund may deduct from a benefit which becomes due to a member or beneficiary, in terms of the rules, any amount due by the member in terms of the Income Tax Act.[20]

It is an internationally accepted principle that the right of the state to secure prompt performance of pecuniary obligations to it is paramount. This is because taxation is the means by which the state raises the necessary funds to govern from day to day and provide the necessary services and facilities to its citizens. The state thus requires the maintenance of a stable and predictable collection of taxes. This in turn requires that it is empowered not only to act against dishonest or recalcitrant taxpayers, but also to avoid any delays in the collection of taxes.

Nevondwe further urged that the provisions in the Income Tax Act permitting deduction for tax from pension benefits are designed to ensure that the pension benefit of a taxpayer cannot be placed beyond the reach of the Commissioner for the South African Revenue Services and further that a speedy recovery of the amount of tax due in respect of that pension benefit is achieved through administrative means.

The following literature review considers the theoretical foundations of the study. The evolution of the past regimes including the pre and post-apartheid era on taxation of pension benefits will be analyzed and It aims to determine whether existing literature supports the reform of taxation for pension benefits in South Africa.

[20] Act,58 of 1962.

According to Nevondwe L, He argues that, a number of inequities and complexities which need to be addressed in the tax system have been identified at the same time the tax system needs to maintain sufficient incentives in place to encourage voluntary additional provision for retirement, particularly as the requirements and the cost of regulatory compliance by retirement funds is higher than the requirement and cost of such compliance by other savings vehicles.[21]There are synergies between a robust pension environment and the development of financial markers which in its self has further economic development benefits; and retirement savings institutions provide a stable long-term flow of funds, directed primarily to domestic investment, because funds seek to match their long-term liabilities with appropriate assets.[22]

According to Jonathan D, he argues that, the factors that permitted this high level of income tax collection capacity have been the subject of considerable analysis. First, there has been a high degree of cooperation between the state and upper-income white groups which supported state-led reforms. This challenges the idea that simply instituting and autonomous revenue agency is central to effective tax collection.

Second, the introduction of computerization in the 1960s greatly enhanced the ability of the Department of Inland Revenue to calculate and issue assessments, to record payments, and to register and monitor large tax payers, and maintain

[21] Choma HJ and Nevondwe LT, Socio-Economic Right and financial planning in South Africa , First edition, 2010, David Publishing Company, USA, p281
[22] Ibid, p282

controls on tax payments more generally. Third, the introduction of a withholding Pay-as-you-earn (PAYE) system also greatly enhanced tax collection. This system made employees responsible for withholding taxes on a monthly basis. The willingness of business owners to cooperate greatly reduced the transaction costs of implementing the PAYE system.[23]

According to Botha B, Withdrawal benefits are benefits payable to retirement fund members when they exit the fund prior to retirement. These benefits are partly tax-free and partly taxable. The taxable portion of the lump sum is taxed based on an average formula. All taxable amounts are subject to PAYE withholding before payout. The problem with the abovementioned regime is twofold. Firstly, the tax-free amount is very low and has not been adjusted for a number of years. Secondly, the averaging formula is complex and is dependent upon information which the retirement fund or retirement fund member cannot easily access or determine. The combination of these issues has prompted a need for change.[24] An analysis of the existing literature suggests that the authors who have written on the reform of taxation agree that there are issues in our taxation system for pension benefits that needs to be changed in order to go back to the initial aims and objectives of the pension fund. However is clear that majority are in favor of the reform in that regard.

[23] Jonathan D, The political economy of taxation and tax reform in developing countries, Research Paper, No 2006,74

[24] Botha B, *Proposed taxation changes relating to employees and employers*, 2008, p 28

1.4. Aims and objectives of the study

This study is aimed at conducting an analysis of the current positions of laws, policies, regulations and guidelines concerning the reform of taxation of pension funds and the new proposals in the 2013 budget speech[25] in South Africa.

This aims will be achieved through the making of a new act, the new Act will regulate both public and private pensions' funds[26] because this variety of legislations creates a lot of confusion as they bring contradictory and parallel policy positions on withdrawals and regulation of pension benefits. The National Treasury should increase the R300 000 which is tax-free. This dissertation aims to assist law students, commercial and actuarial students with the focus being but not limited to the taxation of pension funds and economics. It will also be beneficial to government through National Treasury, South African Social Security Agency (SASSA), South African Revenue Services (SARS), Financial Services Board (FSB), Pension Funds Adjudicator (PFA), pension lawyers' association and the retirement industry, and retirement system with regard to accessibility, eligibility and affordability.

1.5. Research Methodology

The research methodology to be adopted in this study is qualitative as opposed to quantitative. This research is library based and reliance is on library materials such as textbooks, reports, legislations, regulations, case laws and articles.

[25] Gordhan P, Budget Speech, 27 February 2013.
[26] This speaks to, The government Employees' Pension Law of 1996 which regulate government employees pension fund, the Transnet Pension Fund Act 62 of 1990,the South African post office act and the Special Pension Act 69 of 1996.

Consequently, a combination of legal comparative and legal historical methods, based on jurisprudential analysis is employed. A legal comparative method will be applied to find solutions, especially an investigation for the reform of taxation of pension benefit.

The study established the development of legal rules, the interaction between law and social justice, and proposed solutions or amendments to the existing law or constitutional arrangement, based on practical or empirical and historical facts. Concepts were analysed and arguments based on discourse analysis were developed. A literature and case law survey of the pension law will be provided.

1.6. Scope and limitation of the study

The study consists of four interrelated chapters. The first chapter deals with the introduction which will lay down the foundation of the study. Chapter two will deal with taxation of pension benefits, chapter three deals the comparative study between South Africa, United Kingdom and Canada. The last chapter will conclude the study and also provide the recommendations.

CHAPTER TWO: TAXATION OF PENSION BENEFITS

2.1. Introduction

To simplify the retirement system, government proposes a uniform retirement contribution model, under which all contributions to retirement funds- including annuities, pension and provident funds and all benefits contributions to all types of funds will be included in an employee's remuneration as a fringe benefit, but individuals will be permitted a deduction of up to 22.5% of their income if they are under 45 and 27.5% if they are 45 and above. This will apply to both employers and employee contributions.[27]

It is an internationally accepted principle that the right of the State to secure prompt performance of pecuniary obligations to it is paramount.[28] This is because taxation is the means by which the State raises the necessary funds to govern from day to day and provide the necessary services and facilities to its citizens. The State thus requires the maintenance of a stable and predictable collection of taxes. This in turn requires that it is empowered not only to act against dishonest or recalcitrant taxpayers but also to avoid any delays in the collection of taxes. The provisions in the Income Tax Act[29] permitting deduction for tax from pension benefits are designed to ensure that the pension benefit of a taxpayer cannot be placed beyond the reach of the Commissioner for Inland

[27] National Treasury, Strengthening Savings Retirement , discussion paper, 14 May 2012, p 13.
[28] Shrosbree L, Taxation of benefits from approved pension funds, LLM dissertation, UCT.
[29] Act 58 of 1956.

Revenue and further that a speedy recovery of the amount of tax due in respect of that pension benefit is achieved through administrative means.[30]

There are various retirement legislations in South Africa. These legislations are different and this creates a lot of confusion for the members of the funds.[31] The Financial Services General Laws Amendment Act has introduced the so called beneficiary funds which will replace the trust funds. The beneficiary funds are subject to tax.[32] The legislative framework which is ongoing on the taxation of pension benefits will be discussed below.

2.2. Lump sum benefits and annuities

There are two types of pension benefit which must be distinguished for the purposes of the income tax act, namely lump sum benefits and pensions or annuities. Changes to the provisions of the Income Tax Act[33] (the Act) affecting the taxation of lump sum benefits received from pension, pension preservation, provident, provident preservation and retirement annuity funds (Retirement Funds) have been made since 2007 and as is evidenced in the Taxation Laws Amendment Act, 2010.[34]

The new tax dispensation which applies to any retirement fund lump sum benefit (RLB) came into effect from 1 October 2007 while the new tax dispensation applying to retirement fund lump sum withdrawal benefits (RLWB) is effective

---

[30] Shrosbree L, Taxation of benefits from approved pension funds, LLM dissertation, UCT.
[31] Draft Taxation Laws Amendment Bill, 2009.
[32] Nevondwe L, Recent legislative framework of the taxation of pension benefits, Insurance and Tax; Vol. 24, No 4, December 2009, p 1.
[33] 58 of 1962.
[34] Ibid

from 1 March 2009. A lump sum benefit includes any amount determined in respect of the commutation (conversion) of an annuity or portion thereof and any fixed or ascertainable amount payable by or provided in consequence of membership or past membership of a retirement fund, whether in one amount or in instalments. A lump sum benefit does not include any amount deemed to be income accrued to a person in terms of section 7(11) of the Act, namely a deduction from the minimum individual reserve in terms of section 37D of the [35] PFA.

Included in the definition of gross income, found in section 1 of the Act,[36] is any amount received or accrued as a RLWB. The Second Schedule to the Act determines the taxable portion of the RLB and the RLWB by deducting from the aggregate of the lump sum benefits any allowable deductions. Any distribution received subsequent to a member's death, retirement or withdrawal from a retirement fund in terms of a surplus apportionment scheme as contemplated in section 15B of the PFA[37] does not constitute gross income, i.e. the surplus apportionment is not taxable.

In 2013, the exemption amount was set at R300 000 (without regard to prior years of service) for lump sums upon retirement and the complex averaging formula for lump sum benefits would upon retirement was removed in favour of a special rates table.in 2008, the exemption for pre-retirement lump sum benefits was set at R22 500 for 2009/10 (in lieu of long standing pre-existing threshold of

[35] Act 24 of 1956.
[36] Ibid
[37] Ibid.

R1 800). It was also announced that the complex averaging formula of section 5(10) applicable to pre-retirement lump sum benefits would be modified in favour of a simplified table below.[38]

2.2.1. Pre-retirement taxation

Taxable income from lump sum benefits	**Rates of tax**
0-R25 000	0 per cent of taxable amount
25 001- 660 000	18 per cent of taxable income exceeding R25 000
660 001-990 000	114 300 plus 27 per cent of taxable income exceeding R660 000
R990 001and above	R203 400 plus 36 per cent of taxable income above R990 001.

2.2.2. Retirement taxation

Taxable income from lump sum benefits	**Rate of tax**

[38] Nevondwe L, Recent legislative framework of the taxation of pension benefits, Insurance and Tax Journal, vol. 24, No 4, December 2009, p1

0-R500 000	0 per cent of taxable income
R500 001-700 000	18 per cent of taxable income above R500 000.
R700 001-1 050 000	R36 000 plus 27 per cent of taxable income above R700 000.
R1 050 001 and above	R130 500 plus 36 per cent of taxable income above R1 050 001

2.3. Divorce benefits

Upon divorce, the retirement savings[39] that a member has accrued is distributed between the member and his spouse.[40] This is in terms of section 37D of the Pension Funds Act,[41](also known as the clean break principle).In terms of the clean- break principle a retirement fund may be obligated to award a certain portion of a members interest in such fund to the non-member ex-spouse. This can be done either in cash or as a transfer to the non-member ex-spouses own retirement fund.

---

[39] It is important to note from the outset that the terms 'pension interest', 'retirement savings' and 'retirement benefits' has vastly different meanings, which will be explained in due course.
[40] For purpose of this research, it will be assumed that all member spouses are male and therefore all non-member spouses are females.
[41] Act 24 of 1956.

Prior to the enactment of section 7 (7) and (8) of the Divorce Act,[42] the spouse member of a retirement fund had no right to a share of his or her retirement savings in that fund on divorce unless a benefit had accrued to the member[43] prior divorce. The effect of section 7(7) is to deem the pension interest of a party to the divorce action to be part of his assets for the purposes of the divorce. Section 7(7) (c) excludes from the ambit of the section marriages entered into on or after 1 November 1984 where the spouse have opted for a complete separation on their estates without the accrual system. This section thus applies to the three remaining marriage regimes in south African law namely, marriages in community of property; marriages to which the accrual system applies; and marriages entered into prior 1 November 1984 in terms of an ante-nuptial contract excluding community of property and community of profit and loss.

In terms of section 7(8)(a)(i) of the Divorce Act,[44] the former spouse of a member of a retirement fund on divorce could be awarded by the court a portion of the benefits that the member would have received had he or she resigned on the date of the divorce. However in terms of the Divorce Act, reads with the Government Employees Pension Law,[45] the former spouse was only entitled to receive that share when the member becomes entitled to a benefit in terms of the fund, that is, on his or her latter retirement or termination of

---

[42] Act 70 of 1979.
[43] See De Kock v Jacobson and Another 1999 (4) SA 346(W), where the issue for determination was whether a retirement benefit consisting of a lump sum and a pension for the member (which accrued prior to the divorce date) formed part of the joint estate. The court held that there was no longer or legal reason as to why both components of the retirement benefit should not ordinarily form part of the joint estate.
[44] Act 70 of 1979.
[45] Proclamation 21 of 1996.

membership, which could have been many years after the date of the divorce.[46]

2.3.1. Taxation of divorce benefits and taxation of pension interest allocated in accordance with the clean break principle

The "Clean Break" principle has largely been entranced in private sector funds through the application of the Pension Funds Act[47] action and the income tax act.[48] However, if a non-member ex-spouse presents the divorce order to the private sector fund, he/she may occasionally fail to claim payment of the divorce award prior to the member ex-spouse exiting the fund. In this event, the effect might well be that the member ex-spouse remains liable for the tax on the portion of the pension interest assigned to the non-member ex-spouse. The pending charges ensure equal application of the "Clean Break" principle regardless of the timing of the payment to the non-member ex-spouse.[49]

Under current law, the "Clean-Break" principle has been introduced in private sector funds. The GEPF which operates under the Government Employees Pension Law as amended[50] has introduced the "Clean-Break" principle for the division of pension benefits and it is expected that other public sector funds like

---

[46] The non-member spouse was not entitled to interest in respect of her share of the returns earned by the fund on its investment during the period from the date of divorce to the date on which it was paid to her. Its value accordingly reduced in the interim.
[47] 24 of 1956.
[48] 58 of 1962.
[49] National budget review, 2012: Taxation of divorce order-related retirement benefits, media statements, 13 march 2012, National Treasury, www.tresury .gov.za, accessed on 14 April 2013.
[50] Proclamation 21 of 1996.

the Transnet Pension Fund and the post office retirement fund will soon follow. Given the regulatory changes, the tax regime as from 1 march 2012 effectively placed all public sector fund members on equal footing with private sector fund members as regards to the application of the “Clean Break” principle.[51]

To the extent that an amount is deducted from the minimum individual reserve of the member ex-spouse in terms of a maintenance order, section 7(11)[52] of the Act provides that such amounts are deemed to be have accrued to the member ex-spouse on the date of the deduction. These amounts do not constitute lump sum benefits but are defined as "remuneration" in terms of the Fourth Schedule to the Act[53] and subject to the deduction of PAYE[54] in the member spouse’s hands.

In respect of awards received on or after 1 March 2009, divorce orders granted before 13 September 2007, the date of accrual is determined by the date that the non-member ex-spouse chooses to withdraw the award from the member ex-spouses fund or to have the award transferred to another fund, The member ex-spouse would be liable for tax calculated in terms of the new rates of tax (this can be recovered from the non-member ex-spouse). divorce orders granted on or after 13 September 2007, the date of accrual is determined by the date the amount stated in the divorce order must be deducted from the member ex-

[51] Ibid
[52] Act 24 of 1956.
[53] 24 0f 1956.
[54] Pay as you earn.

spouses minimum individual reserve, The non-member ex-spouse would be liable for tax calculated in terms of the new rates of tax.[55]

The accrual date is to be the date: The non-member elects to have the amount paid in cash; or if no election is made within the 120 days period during which he or she can make an election, the date on which the benefits is paid; or If the non-member spouse elects to have the amount transferred to another retirement fund, the date of the transfer to that fund.[56]

NR v ER and Another,[57] the court, held that when the parties concluded the settlement agreement with reference to the Income Tax Act and in accordance therewith, the applicant was clearly responsible for the payment of his tax because the first respondent's 30% interest in the applicant's pension, strictly speaking, first accrued to the applicant, and only thereafter accrued to the first respondent upon the payment of her 30% interest in his pension and, consequently, the tax payable accrued to the applicant's account as it was levied on the pension lump sum paid to him.

However, he continued, when the parties entered into the settlement agreement at the time of the divorce, it could never have been in their contemplation that the PFA would in future be amended to enable the non-

[55] Proclamation 21 of 1996.
[56] Nevondwe L, Recent legislative framework of the taxation of pension benefits, Insurance and Tax Journal, Vol. 24, No 4, December 2009, p1.
[57] 2012 (2) SA 481 (GSJ).

member spouse to be entitled to the earlier payment of her 30% assigned interest in the applicant's pension, because s 2B of the Second Schedule to the Act was extant at the time of the dissolution of the marriage.

Pursuant to the dictates of section 37D(4)(*b*)(i) of the *Pension Funds Act* a nonmember spouse makes an election to enforce an order made in terms of s 7(8)(*a*) of the *Divorce* Act, the assigned 30% interest in the member's pension is taxed separately and that is evident and reaffirmed by the last portion of s 2B.[58]In the result the court ordered the first respondent to pay to the second respondent the amount of R135 614, 27 to be paid to the credit of the applicant's pension interest in the second respondent and the first respondent was ordered to pay the applicant's costs.[59]

2.4. Death benefits

In 1976, the Pension Funds Act[60] was amended to include section 37C.[61] This section regulates the payment of any benefit payable upon the death of a member of a Pension Fund Organisation. The primary object of a pension fund organisation as defined in the Act read with the Income Tax Act[62] is to provide benefits to members of retirement funds when they retire from employment on reaching their retirement age.[63] If a member dies before he retires, the pension fund must pay the benefit to his dependants and nominees. This is dealt with by

---

[58] Second schedule of Act 58 of 1962.
[59] South African case records, vol. 74 part 4.
[60] 24 of 1956.
[6161] Mhango MO, An examination of the accurate application of the dependency test under the Pension Funds Act 24 of 1956 South African Mercantile Law Journal (SAMLJ) vol. 20 (2008) S126.
[62] 58 of 1962.
[63] Nevondwe L, Section 37C of the Pension Funds Act, 24 of 1956: A social security measure to escape destitution, Insurance and Tax Journal, vol. 26 No3, p3.

section 37C of the Act, which prescribes to the board of management of a person fund how it should deal with the member's interest in the fund.[64]

Section 37C reads as follows:

"notwithstanding anything to the contrary contained in any law or in the rules of a registered fund, any benefit payable by such a fund upon death of a member, shall subject to a pledge in accordance with section 19(5)(b)(i) and subject to the provisions of section 37A(3) and 37D, not form part of the assets in the state of such a member but shall be dealt with…."

The section seeks to ensure that those who were dependent on the deceased member are not left destitute by that latter's death.[65] To achieve this objective, section 37C overrides the freedom of testation, and the board of management is not bound by the wishes of the deceased as expressed in the nomination form. For this reason, the death benefit subject to the exceptions outlined in section 37C is excluded from the estate of the deceased member and placed under the control of the retirement fund.[66]

2.4.1. Who is a dependant?

From a reading of section 37C in its entirety, it is clear that dependants are favoured over nominees in the allocation phase. Under section 37(1) and board

---

[64] Ibid.

[65] Nevondwe L, Is the distribution of death benefits under the Pension Funds Act 24 of 1956 constitutional? Juta Business Law Journal, Vol. 15, p164.

[66] Nevondwe L, Section 37C of the Pension Funds Act, 24 of 1956: A social measure to escape destitution, Insurance and Tax Journal, Vol. 26 No3, p4.

has a duty to take all reasonable steps to trace and locate the dependents of the deceased member. What constitutes a reasonable investigation by the board will differ from case to case. The mere fact that a person qualifies as a dependent does not entitle him to the entire benefit, but only to be considered by the board in the allocation phase.

The Act[67] defines a "Dependent" in section 1 as follows:

(a) A person in respect of whom the member is legally liable for maintenance;

(b) A person in respect of whom the member is not legally liable for maintenance, if such person-

  (i) Was, in the opinion of the board, upon the death of the member in fact dependent on the member for maintenance ;

  (ii) Is the spouse of the member;

  (iii) Is a child of the member, including a posthumous child, an adopted child and a child born out of wedlock;

(c) A person, in respect of whom the member would have become legally liable for maintenance, had the member not died.

2.4.2. The twelve-month period

The board has twelve months in which to trace and identify the possible beneficiaries that might share in the benefit. If satisfied that it has taken all

[67] 24 of 1956.

reasonable steps to trace and identify dependants,[68] the board need not wait for the twelve months to lapse before making payment. Nor is it obliged to pay after the twelve months have lapsed if it considers that further investigation is needed.[69] The duty to pay depends not on the expiry of the twelve-month period, but on whether the board is satisfied that it has investigated and considered the matter with due diligence and can make an equitable allocation.[70]

The twelve months period is relevant only as regards payment to a nominee. A designated nominee will be considered only after the twelve-month period has lapsed and the fund has not managed to trace a dependant. Any claim by a nominee before the twelve-months have lapsed will be premature.[71] Whether the board acted properly under section 37C (1)(a) will thus not necessarily be determined with reference to the time-frame. The relevant question will always be whether the board took all the reasonable steps necessary to identify and trace all possible dependants so as to allow it to distribute the benefits in the most equitable manner.

---

[68] The duty to trace and identify dependents' rests on the fund, which should take all reasonable steps to identify the dependents. There is no duty on a dependents to come forward and prove that he is a dependent (*Mthiyane v Fedsure Life Assurance Ltd and Others (2) [2002] 5 BPLR 3460 (PFA)).*

[69] But it does not mean that the board can delay in its decision. If the board fails to take a decision in time without good reason, this will amount to maladministration giving rise to a claim for delictual damages for any quantifiable loss suffered.

[70] Dobie NO v National Technikon Retirement Pension Fund [1999] 9 BPLR 29 (PFA).

[71] Nevondwe L, Section 37C of the Pension Funds Act, 24 of 1956: A social security measure to escape destitution, Insurance and Tax Journal, Vol. 26 NO3, p10- 11.

An enforceable debt of a dependant entitled to share in a benefit does not arise when the twelve-month period has lapsed, but when the board has taken a decision to distribute the benefit to the selected beneficiaries.[72] If the board of trustees failed to comply with the act and the beneficiaries therefore lodge a complaint with the office of the pension funds adjudicator, the adjudicator may order the board of trustees to complete its investigation and distribute the benefit under section 37C, together with interest on it of 15,5 per cent from the date when the period of twelve-months elapsed to the date of final payment within six weeks of the date of determination.[73]

2.4.3. Allocation of death benefits

Section 37C establishes a statutory hierarchy of beneficiaries entitled to share in the allocation of death benefits. Dependency will always be the overarching requirement in this allocation, keeping in mind that the objective of the section is to ensure that dependants of the deceased are not left destitute by his death.[74]

In *Karam v Amrel Provident Fund*[75] the deceased was survived by her major son and a close friend, whom she nominated as a beneficiary. Both of them were financial independent. The deceased and her son were estranged from each other up to her death. Before they became estranged, the deceased

---

[72] Ibid, p11.
[73] See Nzimande v South African Retirement Annuity fund.
[74] Nevondwe L, Section 37C of the Pension Funds Act, 24 of 1956: A social security measure to escape destitution, Insurance and Tax Journal, Vol. 26 NO3, p 11.
[75] [2003] 9 BPLR 4260 (PFA).

nominated her son as sole heir, but later revoked the nomination. The fund awarded the entire benefit to the nominee. The adjudicator confirmed the decision of the fund and held that where dependants are mature adults and gainfully employed, their relationship with the deceased becomes a critical factor.

In *Robinson v Central Retirement Annuity Fund*[76] the adjudicator found that the fund exercised their discretion improperly for failing to consider that the deceased was required by a divorce order to pay for the reasonable maintenance needs of the complainant, a minor child.

Section 37C of the Pension Funds Act provides that any benefit payable by a fund upon the death of a member is deemed not to form part of the assets of the estate of such member.[77] Yet for the purpose of taxation, paragraph 3 of the second schedule to the Income Tax deems the death benefit to be in gross income of the deceased member and thus subject to applicable deductions for tax in terms of the income tax act.[78]

2.5. Conclusion

[76] [2001] 10 BPLR 2623 (PFA).
[77] The latter protects death benefits payable to the deceased's dependents from erosion by creditors.
[78] Nevondwe L, Recent legislation framework of the taxation of pension benefits, Insurance and Tax Journals, Vol. 24, No4, December 2009, P2.

Retirement funds, in South Africa, are the pivotal institution for the management of the middle class financial lifecycle and its attached risks: death, disability, dismissal and divorce. The Act is a step towards addressing issues which affect both the pensioners and the beneficiaries. The clarification on the clean-break principle is long overdue. The payment of benefits to the former spouse on the date of divorce is a good thing as the non-member spouse will not have to wait for payment until the retirement, death or resignation of the member spouses who belongs to the GEPF.

The reason why beneficiary funds were introduced are because there has been mismanagement and abuse of death benefits allocated to minors and widows by pension funds, held in trust, by trust funds. Reform should also facilitate life and disability cover being paid monthly: tax considerations discourage the former, restrictions on the benefits that can be paid by retirement funds the latter.

CHAPTER 3: COMPARATIVE STUDY BETWEEN SOUTH AFRICA, UNITED KINGDOM, AUSTRALIA AND CANADA

3.1. Introduction

Every country has its own laws and customs that governs it, this chapter will look at laws of different countries on how each country handles the laws operating within their retirement benefits. The countries to be compered are South Africa, United Kingdom, Australia and Canada**.**

3.2. South Africa

In the 1970's, most retirement funds in South Africa and in fact worldwide were defined benefit funds, managed by employer-appointed boards of management. Benefit design favored retirement and death but penalized resignation: a member's own contributions were refunded with a rate of interest lower than rates available on discretionary savings, and an increase (representing a share of employer contributions) was only included after a long period of service, in order to encourage employees to commit to their employer for the long-term.[79]

The 1980's and 1990's saw a dramatic transfer of employees from these defined benefit funds to defined contribution schemes. This was viewed positively by trade unions, which saw advantages for their members in the better resignation

[79]Maynard C.E, Pension fund investment management in South Africa, MBA Research Report, Johannesburg, University of the Witwatersrand.

benefits offered by newly established national provident funds, and by white-collar employees who sought to capture the investment rewards of a bull market. Employers preferred a defined contribution arrangement, since it provided for the capping of their personnel expenses, eased the introduction of package remuneration approaches, and it transferred the investment and expense risks to the employee. In most cases the old defined benefit fund was closed to new employees.[80]

Today the South African retirement funding system hosts a variety of funds, from defined benefit and defined contribution, to hybrid funds, and multi-employer funds. It is suggested that the new Act acknowledge the intricacies of each type of fund, but provide an equitable structure under which all funds must operate.

3.3. United Kingdom

A Personal Pension Scheme (PPS), sometimes called a Personal Pension Plan (PPP), is a United Kingdom(UK) tax-privileged individual investment vehicle, with the primary purpose of building a capital sum to provide retirement benefits, although it will usually also provide death benefits. These plans first became available on 1 July 1988 and replaced Retirement Annuity Plans. Both the individual can contribute as well as their employer. Benefits can be taken at any time after age 55 if the plan rules allow, or earlier in the case of ill health.

[80] Ibid.

In the past, legislation required benefits to be taken before age 75, and many plans still contain this restriction.[81] Part of the fund (usually 25%) may be taken as a lump sum at retirement. There are two types of Personal Pension Scheme: Insured Personal Pensions, where each contract will have a set range of investment funds for plan holders to choose from (this is not as restrictive as it sounds, as some modern schemes have over 1,000 fund options) and Self-Invested Personal Pensions (SIPPs). Insured Personal Pensions with charges capped at a low level, and which satisfy certain other conditions, are known as Stakeholder Pensions.

Contributions to a PPS can be made either from the individual or from an employer. Employer-sponsored pension plans in the United Kingdom must be registered under section 153,[82] as amended from time to time, in order to qualify for the full range of pension scheme tax reliefs that apply to contributions, investments, and benefits. This provision came into effect on April 6, 2006, when a single, universal regime for tax-privileged pension savings was introduced to replace the pre-existing tax-approved regimes. Occupational Pension Schemes, Personal Pension Schemes (including Individual Stakeholder Plans), and certain other types of schemes all have to be registered.

Tax relief under section 188[83] is available for contributions made into a UK registered pension scheme. However, only contributions in an Occupational Pension Scheme would qualify as an employer-sponsored pension plan.

---

[81] Atkinson M, Creedy J and knox D, *Alternative retirement income strategies: A cohort analysis of lifetime redistribution, economic record*, 1996, p 72, 97-106.
[82] The Finance Act, 2004.
[83] Ibid.

Employee's contributions to an Occupational pension scheme may also be deductible in Canada. An employer can contribute an amount of up to the annual allowance each year, provided that they can demonstrate to the local inspector of taxes that this contribution has been made wholly and exclusively for the purposes of the business.

This definition is open to wide interpretation and HMRC have yet to provide any more concrete guidelines.[84]An employer's contribution is paid gross and is an allowable expense against income or corporation tax. The PPS fund itself grows tax-advantageously in that it is not subject to UK Capital Gains Tax. In addition, any income generated by assets within the pension fund does not suffer any additional tax although the pension fund cannot reclaim any withholding tax already deducted from that income.[85]

3.4. Australia

Superannuation was first paid in the mid-1800s as a benefit to certain employees of the public service and larger corporate organisations. In 1915, the first concessions for Superannuation were introduced (with the introduction of Income Tax), comprising tax deductibility for employer contributions and an exemption of Superannuation fund earnings from tax. Reforms to the taxation of Superannuation benefits were introduced in 1983.[86] The taxation of lump sum

---

[84] Ibid.
[85] Clark T, and Emmerson C, The tax and benefit system and the decision to save in a stakeholder pension, briefing note no. 28, London : institute for fiscal studies, 2002.
[86] Commonwealth treasury of Australia, Inquiry into superannuation and standards of living in retirement, submission to the senate selection committee on superannuation, July 2002.

payments was raised to 15 per cent for amounts below a specified threshold, and amounts above this threshold were taxed at 30 per cent.

Until 1986, Australia had a two pillar system[87] comprising the Age Pension and voluntary savings. Individuals who were not paid Superannuation by their employers had to save if they wanted an income above the Age Pension, and were encouraged to do so with Superannuation tax concessions. The first compulsory retirement saving scheme begun in 1986, when industrial awards required individuals to have 3 per cent of their remuneration paid as Superannuation contributions. Further revisions to the taxation of Superannuation were announced in 1988, when a 15 per cent tax rate was applied to the contributions and earnings of superannuation funds. To compensate for these changes, the government reduced the tax on lump sums to zero for amounts up to the threshold and 15 per cent for amounts above it. Higher amounts of tax applied if a benefit was greater than the reasonable benefit limit.[88]

In 1996, the Superannuation surcharge was introduced to reduce the disparity between the concessions provided to low-income and high-income earners. The surcharge added an additional amount of tax on contributions made by or on behalf of higher income earners. The surcharge was abolished in 2005. Since 1 July 2007, Superannuation benefits have been tax-exempt when paid to an individual aged 60 years or older. Benefits are still taxed when taken before this

[87] Seager H, 1910 Social Insurance, First addition, MacMillan publishers, 2001.
[88] Ibid.

age, or when paid from a fund which has not paid tax on its contributions and earnings.[89]

3.5. Canada

Federal policy in the area of retirement income stretches back over 100 years, with the introduction of the Canadian Government Annuities Act.[90] The purpose of this legislation was to encourage Canadians to purchase government annuities as a means of saving for retirement. This program resembled the modern Canadian RRSP. Individuals would purchase financial assets; these assets, in turn, would pay out regular benefits upon the individual's retirement from the workforce. Under the *Act*,[91] the Federal Government guaranteed these benefits and assumed all costs associated with their administration.

In 1965, the Federal Government further reformed the public pension regime when it introduced the Canada Pension Plan (CPP).general government revenues.[92] The CPP, by contrast, was a compulsory social insurance plan, in which employees and employers contribute towards a wage-related retirement pension, and included long-term disability and survivors' benefits. When it was

[89] Bateman H and Piggott J, Australia's mandatory Retirement Saving Policy: A view from the new millennium, pension reform primer, Electronic Discussion Paper 4, August 2000.
[90] Canadian Government Act, 1908.
[91] Ibid.
[92] Cooke M, The Canada Pension Plan goes to market, Canadian review of social policy, issue 51, July 2003.

first introduced, the CPP covered approximately 92 percent of the labour force and was designed to replace 25 percent of the average industrial wage.[93]

CPP is a contributory, earnings-related social insurance program. It ensures a measure of protection to a contributor and his or her family against the loss of income due to retirement, disability and death. There are three kinds of Canada Pension Plan benefits: disability benefits (which include benefits for disabled contributors and benefits for their dependent children), retirement pension, survivor benefits (which include the death benefit, the survivor's pension and the children's benefit). [94] With very few exceptions, every person in Canada over the age of 18 who earns a salary must pay into the Canada Pension Plan. The member and employer each pay half of the contributions. If a person is self-employed, they pay both portions. Members do not make contributions if they are receiving a Canada Pension Plan disability or retirement pension.

At age 70,[95] a member must stop contributing even if they have not stopped working. The amount paid is based on the salary. For the purpose of the Canada Pension Plan, a "spouse" is the person to whom you are legally married. "Common-law partners" is defined as two people, regardless of sex, who have lived together, in a conjugal relationship for at least one year.[96] When a marriage or common-law partnership ends, the Canada Pension Plan credits built up by the couple, during the time they lived together, can be divided

[93] Battle K, Canada Pension Plan, the Canadian encyclopedia, 12 June 2013.
[94] Ibid.
[95] Guest D, Old Age Pension, The Canadian Encyclopedia, 12 May 20013.
[96] Canadian Government Annuities Act, 1908.

equally between them. Credits can be split upon divorce or separation even if one spouse or common-law partner did not pay into the Canada Pension Plan.[97]

3.6. Conclusion

This chapter considers the evolution of the pension reform programmes of South Africa, United Kingdom, Australia and Canada, how successive reforms have affected the living standards of past and current generations of pensioners, and how they are likely to affect the future generations. The remainder of the analysis of the taxation of South African pension funds focussed lump sum benefit, death benefits and divorce benefits on the implications of the clean break principle. In relation to size of the economy, South Africa has one of the largest pension fund industries in the world.

The Canada pension plan helps ensures a minimum threshold of retirement income. Nevertheless, it does not ensure income equality between persons in their retirement. Instead Canada's retirement income scheme, of which CPP is an important element, permits (and even encourages) a growing disparity. In contrast, Australian retirement income system will thus remain quit complex. The financial planning to manage the investment of lump sum distribution, to reduce taxation and to increase age pension entitlements, is thus a large and rapidly growing industry and represent significant additional costs in the operation of

[97] Actual report of the Canada Pension Plan, office of the superintendent of financial institutes Canada, office of the chief actuary, 18 October 2007.

Australia's national retirement income system. The issues facing the reformers are not all uniquely South African and much can also be learned from international cases.

CHAPTER 4: CONCLUSIONS AND RECOMMENDATIONS

4.1 Conclusions

This study looked at the current laws, policies and guidelines that govern Pension Funds in South Africa. In particular it analysed the challenges that has made it difficult for the Pension Funds to achieve the intended goal of closing the gap between poverty relief and tax incentivised long-term insurance, on one hand, and encouraging savings measures for low income or irregular income workers. It identified a number of iniquities and complexities which need to be addressed in the tax system.

The study has found that there are various pieces of legislation that relate to retirement, and that there are inconsistencies and contradictions amongst them. In general, these pieces of legislation distinguish, for tax purposes, between lump some benefits and pension or annuities. Withdrawal of lump sum benefits attract taxation at rates that have progressively changed since 2007. There is also taxation in terms of divorce benefits from retirement savings which is based on the “clean break principle”.

The study has also found that in 1976, the 1956 Pensions Fund Act was amended to include Section 37C which regulates the payment of benefits to dependent(s) upon the death of a member. This section provides that any benefit payable by a fund upon the death of a member is deemed not to form part of the assets of the estate of such member, However, this is inconsistent with the Income Tax Act which, in third paragraph of second schedule deems the death benefit to be part of the gross income of the deceased member, and therefore liable for applicable tax deductions.

The comparative analysis of the South African, Australian, Canadian and British systems has confirmed that these four countries have been grappling with more or less the same issues and challenges with regards to taxation of retirement schemes. All have and continue to introduce reforms in the tax regime with a view to reduce the tax burden on retirement savings. The countries have progressed differently in this regard, with Britain (the United Kingdom) giving a tax relief to benefits from contributions to registered pension schemes. Similarly, the Australian Government has reduced the tax on lump sums to zero for amounts up to the threshold, and only 15% for amounts above the threshold.

In Canada as well, the pension plan ensures a minimum threshold of retirement income. In South Africa taxation on lump sum benefits drawn after retirement is far lower than taxation on lump sum benefits drawn after resignation, but before the age of retirement. For instance, after retirement, lumps sum benefit of up to R315 000 are tax free, whilst in pre-retirement the tax-free portion is only up to R22 500.

The study achieved its aim of analysing the laws, policies, regulations, and guidelines that govern the Pension Fund in South Africa. It found that there are a number of these laws, regulations, policies and guidelines and that as a result, there are inconsistencies and contradictions which cause a lot of confusion. The study therefore concludes, on this basis, that there is indeed a need to reform the tax and other laws that govern Pension Fund.

The comparative study involving South Africa, Canada, United Kingdom and Australia leads to the conclusion that the required reforms are a process and not an event. This is so because other three countries are well-developed with a rich history of pension and retirement schemes, and yet they continue to steadily reform the pension fund laws, policies and regulations. In this regard, it is concluded that South Africa should adopt such reforms as an on-going process.

Another conclusion is that the Pension Funds in South Africa are not achieving their intended goal of closing the gap between poverty-relief measures and tax incentivised long-term insurance on one hand, and encouraging savings measure for low income earners, on other. In line with this, the study found that when the Pension Fund was first introduce in 1956 in South Africa, it was generally recognised to be the first ever Pension Fund Act in the world.

The Act came into operation during the apartheid regime and offers little relief to the majority of retirees and this automatically calls for a plethora of reforms in that regard. The main purpose of the pension fund was initially to encourage South Africans working class to save for retirement, but due to circumstances or unpredictable life some do not live or work until the normal age of retirement due to resignation, disability, death, dismissal and retrenchment.

It is also concluded from the study that there are some challenging tasks and issues relating to taxation of pension and other retirement schemes. Some major problems in the taxation of pension tax include (a) the tax-free amount is very low and has not been adjusted for a number of years; (b) the averaging formula is complex and is dependent upon information which the retirement fund or retirement fund member cannot easily access or determine; (c) the high number of deaths before retirement, largely as a result of HIV/AIDS, is contrasted against a rising longevity among retirees; (d) the challenge in introducing a saving culture into an environment where current personal savings levels are negative; (e) the task of administering a compulsory system[98] and (f) the implications of the clean break has led to an increase in the number of divorces.[99] The combination of these issues has prompted a need for change or a reform of the retirement systems.

Another conclusion of the study there is an anomaly in the South African retirement fund system in that if members of a pension fund or provident fund emigrate before they reach retirement, they have the option to resign from their pension or provident fund, pay the tax, convert their retirement savings to cash and apply for the necessary foreign exchange.[100] However, until now, members of retirement annuity funds did not have this option. In terms of their rules they are members until they reach the age of 55.

This had negative consequences for younger, mobile and self-employed people, for whom retirement annuities are illiquid and inflexible as an investment vehicle. As a result they use other “after-tax” savings mechanisms such as endowments and unit trusts, and forfeit the favourable tax treatment within retirement annuities in a similar manner to withdrawing members from any other retirement fund. Retirement annuities are again becoming an attractive method to boost retirement capital and will benefit the self-employed people.[101]

---

[98] Nevondwe L, South African social security and retirement reform: A long journey towards the redrafting of the new Pension Funds Act, Insurance and Tax Journals, Vol.15, No.4, 295.
[99] Ngobeni M, Recent legislative framework of the taxation of pension benefits under the south African Law, LLB Dissertation, University of Limpopo, 2011, p28.
[100] Ibid, 29.
[101] Ibid .

Another general conclusion is that retirement savings are prone to leakage when members fail to preserve their benefits and take them in cash. Tax incentives are viewed as inconsistent with social policy. The private sector holds the view that retirement fund administration is not profitable on its own and costs are exacerbated by low assets build-ups as a result of low income levels and high stuff turnovers. The latter factor also creates high administration activity rates. There is also complex, inefficient and expensive compliance demand placed on providers. Group risk benefits offer cyclical profitability and the number of death pre-retirement must not be underestimated when designing a framework for the entire population.[102]

4.2. Recommendations

The basic recommendation of the study is that there should be reforms in the laws, policies and regulations that govern the Pension Funds in the country. Such reforms should aim at ironing out inconsistencies and contradictions. They should also aim at arriving at a dispensation that encourages people to save for retirement by eliminating the disincentives including high taxation rates on resignations and pre-retirement withdrawal of lump sums. The reforms should similarly bring about flexibility in the administration of such schemes, and ensure that retirement savings are, as a matter of principle, invested in high yielding instruments.

[102] Nevondwe L, South African social security and retirement reform: a long journey towards the redrafting of the new Pension Funds Act, Insurance and Tax Journals, Vol.15, No.4, 296.

It is also recommended that such reforms as explained above should be on-going as have been happening in developed countries with rich histories of taxation and pension or retirement schemes. It should not be a once-off event because the challenges evolve with changes in economic and social systems. What is excellent today might not be good enough in years to come.

Because of the above it is also recommended that the Government should establish a taxation and pension funds research unit either within the National Treasury, or as an autonomous agency. Such research unit or agency should be staffed with law, taxation, economics and sociology researchers, who will continue researching on ways and means of improving the system in response of challenges that the country faces in this regard. The first task of such a research unit would be to look at ways of harmonizing all the laws, polices and regulations that govern taxation and pensions funds so as to eliminate contradictions and confusions.

Another recommendation of the study is that universities should consider making Pension Funds and retirement schemes a subject of study in Law Schools at undergraduate level, and an area of research at graduate level. There is need for more innovative ideas to be developed in this area which impacts almost everyone who has had a job before retiring. Just as there is plenty of research and new ideas about how to make an active professional life enjoyable and sustainable, it is equally important to come up with good ideas of ensuring that our retired life is also made enjoyable and sustainable, and this is where the field of pension funds and retirement schemes come in.

BIBLIOGRAPHY

BOOKS

1. Choma HJ and Nevondwe LT, Socio-Economic Rights and Financial Planning in South Africa, First edition, 2010, David Publishing Company, USA.
2. Jeram N, Introduction to South African Pension Law manual, office of the Pension Funds Adjudicator.
3. Metz R, Paying Less Tax Made Simple, Thirteenth edition, 2008, Metz press.
4. Seager H, 1910 Social Insurance, First edition, MacMillan Publishers, 2001, UK.
5. Hoffman M and Dahlby B, Pension Provision In Canada; Pension System and Retirement Incomes in OECD Countries, First edition, Edward Elger: Cheltenham, 2001.

ARTICLES PUBLISHED IN JOURNALS

1. Botha B, Proposed taxation changes relating to employees and employers, 2008, p28.
2. Nevondwe L, Recent legislative framework of the taxation of pension benefits, Insurance and Tax Journal; Vol. 24, No 4, December 2009, p 1.
3. Botha M, Saverance package: proposed new method of taxation, Insurance and Tax Journal, Vol. 25, No 2, June 2010, p39.
4. Mhango MO, An examination of the accurate application of the dependency test under the Pension Funds Act 24 of 1956, South African Mercantile Law Journal (SAMLJ) Vol. 20, 2008, P126.

5. Nevondwe L, Section 37C of the Pension Funds Act, 24 of 1956: A social security measure to escape destitution, Insurance and Jax journal, vol. 26 No3, p3.
6. Nevondwe L, Is the distribution of death benefits under the pension funds act 24 of 1956 constitutional? Juta Business Law Journal, Vol.15, 2008, p164.
7. Nevondwe L, South African social security and retirement reform: a long journey towards the redrafting of the new Pensions, International Journal, Palgrove Macmillan Publishers, UK, Vol.15, No.4, p295.

POLICIES, PAPERS AND OTHER DOCUMENTS

1. George DT, Analysis of South African pension fund conversations: 1980-2006; developing a model for dealing with environmental changes, university of South Africa, PHD, UNISA 2006.
2. Ramabulana M, Pension Law seminar organised by the University of Limpopo Legal Aid Clinic, presented by the Office of the Pension Fund Adjudicator, 09 June 2006, University of Limpopo (Turfloop Campus).
3. National Treasury, Charges in the South African retirement funds, 13 July 2013.
4. Ngobeni M, Recent legislative framework of the taxation of pension benefits under the South African Law, LLB dissertation, University of Limpopo, 2011, p28.
5. Jonathan D, The political economy of taxation and tax reform in developing countries, research paper, no 2006/74.
6. Gordhan P, Budget Speech, 27 February 2013.
7. National Treasury, Strengthening Savings Retirement, Discussion paper, 14 May 2012, p 13.

8. Shrosbree L, Taxation of benefits from approved pension funds, LLM dissertation, UCT, 2010.
9. National Treasury, National budget review, 2012: Taxation of divorce order-related retirement benefits, media statements, 13 march 2012.
10. Maynard CE, Pension fund investment management in South Africa, MBA Research Report, Johannesburg, University of the Witwatersrand
11. Bruce R, Ageing in Australia: Some modeling results and research issues on policy implications of the ageing of Australia's population, February 1999
12. Commonwealth treasury of Australia, inquiry into superannuation and standards of living in retirement, submission to the senate selection committee on superannuation, July 2002
13. Malcolm E and Simon J, Australia's retirement income system: Implications for saving and capital markets, Cambridge, MA: National Bureau of Economic Research, Working paper 5799, 1996.
14. Bateman H and Piggott J, Australia's mandatory Retirement Saving Policy: A view from the new millennium, pension reform primer, Electronic discussion paper 4, August 2000.
15. Cooke M, the Canada pension plan goes to market, Canadian review of social policy, issue 51, July 2003
16. Atkinson M, Creedy J and knox D, Alternative retirement income strategies: A cohort analysis of lifetime redistribution, economic record (1996) 72, 97-106
17. Department of justice Canada, Canada pension plan, 12 November 2009.
18. Department of justice Canada, Canada Pension Plan Investment Board Act, Issue 40, 1997, 12 November 2009

WEBSITES

1. National Treasury, www.tresury .gov.za, accessed on 14 April 2013
2. www.cra.gc.ca, accessed on 9 May 2013