

## TRANSFER OF PENSION CAPITAL TO INSURER – THE LEGAL SITUATION

### 1. Voluntary Individual Transfers

Typically these are transactions at retirement where a member wishes to buy a living annuity directly from an insurer without the money being transferred to another approved fund in the first instance.

The Pension Funds Act is silent as to what benefits can be paid to members and only requires that it must be in terms of the rules. The Income Tax Act, however, only exempts benefits if the moneys are transferred to another approved fund. Can it be argued that no benefit accrues to the member since he/she instructed the transferor fund to transfer the capital to another institution. We do not think so. Firstly, it is a retirement benefit in terms of the rules of the transferor fund, secondly, in our view the capital now vests in the name of the member even though it may be a policy underwritten by an insurer. Section 16 (1)(z) specifically exempts such transfers to another approved fund from tax.

Should the rules of a fund provide for the purchase of an annuity from a registered insurer, as many rules do, in our view, no moneys can be transferred/ paid to any entity, other than another approved fund, in respect of and at the request of any individual member, without the moneys becoming taxable. Of course, a pension fund is not allowed to pay out more than one-third and to provide an annuity from the balance of the retirement capital or to transfer the balance to another approved fund for same purchase. The transfer of this balance directly to an insurer's insurance product, in our view, would not only render the balance taxable but would also jeopardize the tax approval of the fund.

The administrator's obligation is to obtain a tax directive, and in such cases where in its opinion the transaction should be taxed, the directive should be obtained before the moneys are transferred, to 'play safe'. The administrator must ascertain that it provides full information to the Receiver in the request for a directive, i.e. that the moneys are to be transferred to an insurance company and not to another approved fund in order to purchase an annuity.

If the Receiver issues a nil directive in respect of such transaction, the administrator may act in accordance with the directive. The administrator should advise the member, though, that the directive, in its opinion, is not correct and may be revoked by the Receiver at any time.

Considerable confusion seems to prevail in the industry at the moment with regard to the spirit and letter of Namfisa circular 2 of 2005. We do not share the view of our insurers, in particular that this circular allows the voluntary purchase of a living annuity from an insurer by means of an insurance policy directly. The confusion arise from the fact that insurers are active and offer products both in terms of the Pension Funds Act and in terms of the Long-term Insurance Act. This circular, whatever its intention may have been,

certainly does not provide clarity in this regard. In our view, a retirement benefit applied to purchase a pension cannot leave the jurisdiction of the PF Act and move into the jurisdiction of the Long-term Insurance Act. The PF Act only allows such a transaction if it were done in terms of Section 14, which is designed to deal with 'bulk' transfers between entities without interference of the individuals effected.

Our view draws further support from the fact that such a transaction would be undesirable from the Receiver's point of view. The Income Tax Act has different dispensations for the taxation of pension funds (including provident funds, retirement annuity funds and preservation funds) and long-term insurers. Long-term insurers of course manage both types of business and hence they have to clearly distinguish between these two types of business for the purpose of determining its income tax liability. It would be extremely difficult to draw such clear distinction between taxable and tax exempt business, if capital was allowed to migrate from 'tax exempt business' to taxed business yet remain tax exempt. Alternatively it would convert to taxed business, something which the individual concerned might not want.

## **2. Section 14 Transfers for Purchase of Annuity**

Typically these are transactions where a fund wishes to outsource its pensioners in bulk. The intermediary may wish to purchase living annuities directly from an insurer without the money being transferred to another approved fund in the first instance.

Section 14 of the Pension Funds Act does allow for transfers to other entities and such transaction can be approved legitimately by the Registrar. In terms of the Income Tax Act, there could be an argument that no benefit accrues to the member as it is a compulsory transfer, in which he or she had not say, from one entity to another and the benefit that accrues to the member will then only be the annuity. In terms of this argument, this transfer should therefore be tax exempt.

In our view, section 14 does not envisage that an individual member acquires ownership and takes on full risk, in consequence of a transfer (the section refers to the amalgamation of business of bodies). It is in this regard therefore, also important that the approval of the section 14 is done on the basis of a full disclosure of the details of the transaction to Namfisa. It is particularly important that Namfisa is aware that ownership will de jure and de facto vest in the member and that the member assumes full risk. (Section 14 refers to the vesting of the asset and the liability in the receiving entity, which surely is not the case if a living annuity policy is issued to the individual member, as legal and factual owner of the policy?)

If ownership changes from a fund to an individual in the process, it may very well be argued by the Receiver, that a benefit does accrue to the member in terms of the definition of 'gross income', particularly if living annuities are to be purchased.

As the administrator and as the consultant in such a transaction, as things stand at the moment, RFS is not prepared to run any risk though, and will require that either an

indemnity is obtained with regard to any potential tax liability, arising from such transfer, from the receiving entity, or that a tax ruling is obtained from the Receiver. The ruling must be obtained before the moneys are transferred. It is essential that full information is provided to the Receiver in the request for a ruling, i.e. that the moneys are to be transferred to an insurance company and not to another approved fund in order to purchase an annuity owned by the member and not another approved fund. RFS would then act in accordance with that ruling.