Preamble

In this Note unless the context indicates otherwise –

- “Pension Funds Act” means the Pension Funds Act No. 24 of 1956;
- “Schedule” means a Schedule to the Income Tax Act;
- “section” means a section of the Income Tax Act; and
- any other word or expression bears the meaning ascribed to it in the Income Tax Act.

1. Purpose

This Note provides guidance and clarity on the treatment of maintenance orders and the tax-on-tax principles relating to maintenance orders that retirement funds pay while a member is still a contributing member and has not left the retirement fund.

General Note 37 dated 31 October 2008 is hereby withdrawn.

2. Background

There is an obligation on a person to provide his or her spouse and children with financial support, particularly relating to food, housing, education, healthcare or anything else that may be considered necessary for living.

A maintenance order is normally awarded by a court against a person, in this case a member of the retirement fund, who has the obligation to provide the financial support. Should the member fail to meet this obligation the non-member may approach the court and obtain a maintenance order against the fund directing that the maintenance be deducted directly from the member’s benefit in a retirement fund.

The Pension Funds Act provides that a maintenance order can be deducted from a member’s minimum individual reserve. The Income Tax Act was amended to provide that any maintenance order deducted from a member’s minimum individual reserve is
deemed to be income in the hands of the member,\(^1\) irrespective of whether the amount is paid monthly or annually. The effect of the change is that the spouse claiming the maintenance no longer needs to wait for the member to exit the retirement fund to claim the outstanding maintenance amount.

3. The law

The relevant sections of the Income Tax and Pension Funds Acts are quoted in Annexure A.

4. Application of the law

4.1 Section 37D of the Pension Funds Act

Section 37D(1)(d)(iA) of the Pension Funds Act provides that a registered fund may deduct any amount payable in terms of a maintenance order from a member’s benefit\(^2\) or minimum individual reserve.\(^3\)

A “maintenance order” is defined in the Maintenance Act No. 99 of 1998 as –

“any order for the payment, including the periodical payment, of sums of money towards the maintenance of any person issued by any court in the Republic, and includes, except for the purposes of section 31, any sentence suspended on condition that the convicted person make payments of sums of money towards the maintenance of any other person;”.

A fund can therefore only pay amounts towards maintenance from a member’s minimum individual reserve in such fund if ordered to do so by a court in the Republic.

4.2 Deemed accrual

The maintenance order amount is paid by the fund directly to the non-member or dependant. Section 7(11) provides that although the amount is received by the non-member, it will be deemed to be income in the hands of the member. The amount deemed to have accrued to the member, accrues on the date the amount is deducted from the member’s minimum individual reserve in the retirement fund.

4.3 Fund’s obligation to withhold employees’ tax

The administrator of the fund is an “employer” for purposes of the Fourth Schedule and therefore has a duty to deduct and pay employees’ tax to SARS on amounts paid by the fund.

The term “remuneration” is defined in the Fourth Schedule and includes amounts that are deemed to be income in the hands of the recipient,\(^4\) under section 7(11).

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\(^1\) Section 7(11).
\(^2\) As defined in the Pension Funds Act.
\(^3\) As defined in the Pension Funds Act.
\(^4\) Paragraph (f) of the definition of “remuneration” in paragraph 1 of the Fourth Schedule.
The maintenance amount paid to the non-member is taxed as remuneration in the hands of the member\(^5\) and exempt in the hands of the non-member.\(^6\)

The income deemed to have accrued to a member under section 7(11) is subject to normal tax\(^7\) and the statutory rates of tax for that year of assessment will apply (see Annexure B). The amount is not a lump sum benefit as contemplated in the Second Schedule and is accordingly not subject to tax under the retirement fund lump sum withdrawal benefit tax tables.

The tax liability that arises on payment of the maintenance order to the non-member is not deducted from the maintenance order paid. The fund has to use a further portion of the member’s minimum individual reserve to pay the tax payable on the maintenance order to SARS. Section 37D(1)(e) of the Pension Funds Act provides that a fund may reduce the minimum individual reserve of a member with the employees’ tax that has to be paid under the Fourth Schedule as a result of a maintenance order.

Section 7(11)(b) provides that the employees’ tax payable by the fund on the maintenance order will also be deemed to be income received by the member.

Both these amounts are taxable at the member’s marginal rate of tax and there is no need to apply for a tax directive.

The amount of employees’ tax deducted from the member’s minimum individual reserve results in a further amount that is deemed to have accrued to the member. The additional amount that accrues also attracts a tax liability. Each time an additional amount is deducted from the member’s minimum individual reserve, tax is payable on the additional amount deducted. This is referred to as the “tax-on-tax effect”.

SARS accepts the following formula to calculate the tax-on-tax effect of each additional layer of tax:

\[
\text{(a) Calculate the tax on the amount awarded under the maintenance order.} \\
\text{(b) Multiply the tax determined in step (a) by } \frac{100}{(100 – \text{marginal tax rate applicable to the member})}. \\
\text{(c) Add the figure determined in step (b) to the amount of the maintenance award to obtain the grossed-up amount after iteration.} \\
\text{(d) If the grossed-up amount after iteration as determined in step (c) falls within the same tax bracket as the amount awarded under the maintenance order, the calculations in steps (e), (f) and (g) are not required.} \\
\text{(e) If the grossed-up amount after iteration as determined in step (c) falls into a higher tax bracket than the tax bracket that applies to the amount of the maintenance award, calculate the tax on the grossed-up amount after iteration from step (c).}
\]

\(^5\) Section 7(11) read with the definition of “remuneration” in the Fourth Schedule.  
\(^6\) Section 10(u).  
\(^7\) Defined in section 1(1).
(f) Subtract the figure calculated in step (b) from the tax calculated in step (e).

(g) Multiply the figure determined in step (f) by \(100 \div (100 - \text{marginal tax rate applicable to the member})\).

(h) The taxable benefit derived by the member is equal to the result of step (b) plus the result of step (g) – if applicable. The taxable benefit must be added to the amount of the maintenance award to arrive at the member’s income.

**Example – Tax-on-tax calculation of amount payable in terms of a maintenance order**

The amount payable to the non-member in terms of a maintenance order is R242 534 for the 2016 year of assessment.

The tax to be withheld is determined as follows:

(a) The income tax payable on R242 534 is R48 506,84**

(b) \(R48\ 506,84 \times \frac{100}{(100 - 26)} \) (marginal rate applicable to member) = R65 549,78

(c) Maintenance order after grossing up for the tax payable = R308 083,78 [R242 534 + R65 549,78 [step (b)].

(d) R308 083.78 falls within a higher tax bracket (above R284 100), so steps (e), (f) and (g) must be performed.

(e) Tax on grossed-up amount of R308 083,78, as calculated in (c) above = R66 748,97

(f) Tax [step (e)] - figure calculated in step (b) = R66 748,97 – R65 549,78 = R1 199,19

(g) R1 199.19 [step (f)] \times \frac{100}{(100 - 31)} \) (marginal rate applicable to member) = R1 737,95.

(h) Taxable benefit derived by the member = R65 549,78 [step (b)] + R1 737,95 [step (g)] = R67 287,73.

Total income of the member is R242 534 + R67 287,73 = R309 821,73. Tax is R67 287,73, leaving the net maintenance award amount of R242 534.

The IRP5 certificate of the member must be completed as follows:

<table>
<thead>
<tr>
<th>Code</th>
<th>Amount</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>3601</td>
<td>R242 534</td>
<td>(Deemed income)</td>
</tr>
<tr>
<td>3808</td>
<td>R67 287,73</td>
<td>(Deemed benefit)</td>
</tr>
<tr>
<td>4102</td>
<td>R67 287,73</td>
<td>(Employees’ tax)</td>
</tr>
</tbody>
</table>

** If the member receives a salary or pension the rebate should not be taken into account as the rebate is already taken into account when the employer is deducting PAYE from his or her salary or pension.
5. **Conclusion**

A maintenance order paid by a retirement fund out of the member’s minimum individual reserve is deemed to have accrued to the member on the day the amount is deducted from the member’s minimum individual reserve in the fund. The additional amount paid out of the member’s minimum individual reserve to cover the employees’ tax payable on the maintenance order results in the accrual of an additional deemed amount in the hands of the member. The tax-on-tax formula can be used to determine the additional tax payable as a result of the tax-on-tax effect.

Legal and Policy Division
SOUTH AFRICAN REVENUE SERVICE
Annexure A – The law

Section 7(11)

Any amount received by or accrued to any person by way of deduction from the minimum individual reserve of any other person in terms of—

(a) section 37D(1)(d)(iA) of the Pension Funds Act; or

(b) section 37D(1)(e) of the Pension Funds Act to the extent that the deduction is a result of a deduction contemplated in paragraph (a),

shall be deemed for the purposes of this Act to be income accrued to that other person on the date of the deduction.

The definition of “lump sum benefit” in paragraph 1 of the Second Schedule

“lump sum benefit” includes—

(a) any amount determined in respect of the commutation of an annuity or portion of an annuity—

(i) payable by; or

(ii) provided in consequence of membership or past membership of,

a pension fund, pension preservation fund, provident fund, provident preservation fund or retirement annuity fund; and

(b) any fixed or ascertainable amount (other than an annuity)—

(i) payable by; or

(ii) provided in consequence of membership or past membership of,

a pension fund, pension preservation fund, provident fund, provident preservation fund or retirement annuity fund,

whether in one amount or in instalments, but does not include any amount deemed to be income accrued to a person in terms of section 7(11);

The definition of “employer” in paragraph 1 of the Fourth Schedule

“employer” means any person (excluding any person not acting as a principal, but including any person acting in a fiduciary capacity or in his capacity as a trustee in an insolvent estate, an executor or an administrator of a benefit fund, pension fund, pension preservation fund, provident fund, provident preservation fund, retirement annuity fund or any other fund) who pays or is liable to pay to any person any amount by way of remuneration, and any person responsible for the payment of any amount by way of remuneration to any person under the provisions of any law or out of public funds (including the funds of any provincial council or any administration or undertaking of the State) or out of funds voted by Parliament or a provincial council;
Sub-paragraph (f) of the definition of “remuneration” in paragraph 1 of the Fourth Schedule

“remuneration” means any amount of income which is paid or is payable to any person by way of any salary, leave pay, wage, overtime pay, bonus, gratuity, commission, fee, emolument, pension, superannuation allowance, retiring allowance or stipend, whether in cash or otherwise and whether or not in respect of services rendered, including—

(f) any amount deemed to be income accrued to that person in terms of section 7(11),

Section 37D(1)(d) and (e) of the Pension Funds Act

37D. Fund may make certain deductions from pension benefits.—(1) A registered fund may—

(d) deduct from a member’s or deferred pensioner’s benefit, members interest or minimum individual reserve, or the capital value of a pensioner’s pension after retirement, as the case may be—

(i) any amount assigned from such benefit or individual reserve to a non-member spouse in terms of a decree granted under section 7(8)(a) of the Divorce Act, 1979 (Act No. 70 of 1979) or in terms of any order made by a court in respect of the division of assets of a marriage under Islamic law pursuant to its dissolution; and

(iA) any amount payable in terms of a maintenance order as defined in section 1 of the Maintenance Act, 1998 (Act No. 99 of 1998).

(ii) . . . . . .

(e) deduct from a member’s or deferred pensioner’s benefit, interest or minimum individual reserve, as the case may be, employees’ tax required to be deducted or withheld in terms of the Fourth Schedule to the Income Tax Act, 1962 (Act No. 58 of 1962), as a result of a deduction referred to in this subsection.
Annexure B – Statutory rates of tax for the 2015/16 year of assessment

<table>
<thead>
<tr>
<th>Taxable income</th>
<th>Rate of tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>Not exceeding R181 900</td>
<td>18 per cent of taxable income</td>
</tr>
<tr>
<td>Exceeding R181 900 but not exceeding R284 100</td>
<td>R32 742 plus 26 per cent of amount by which taxable income exceeds R181 900</td>
</tr>
<tr>
<td>Exceeding R284 100 but not exceeding R393 200</td>
<td>R59 314 plus 31 per cent of amount by which taxable income exceeds R284 100</td>
</tr>
<tr>
<td>Exceeding R393 200 but not exceeding R550 100</td>
<td>R93 135 plus 36 per cent of amount by which taxable income exceeds R393 200</td>
</tr>
<tr>
<td>Exceeding R550 100 but not exceeding R701 300</td>
<td>R149 619 plus 39 per cent of amount by which taxable income exceeds R550 100</td>
</tr>
<tr>
<td>Exceeding R701 300</td>
<td>R208 587 plus 41 per cent of amount by which taxable income exceeds R701 300</td>
</tr>
</tbody>
</table>

Rebates

- **Primary rebate**: R13,257
- **Secondary rebate (Additional for persons of 65 years or older)**: R7,407
- **Third rebate (Additional for persons of 75 years or older)**: R2,466

Tax thresholds

The tax thresholds at which the liability for normal tax commences are –

- **persons below 65 years**: R73,650
- **persons 65 years but not yet 75**: R114,800
- **persons 75 years or older**: R128,500