

Retirement Fund Practice Note RF 1/95 (Augmentation of benefits by approved pension and provident funds)

SARS Practice Note RF 1/95

Augmentation of benefits by approved pension and provident funds

The purpose of this practice note is to convey Inland Revenue's requirements in respect of the application of reserves or surpluses in pension and provident funds to augment benefits on withdrawal, retirement, death or termination (in part or full) of such funds, to the pensions industry.

It is accepted that circumstances may arise from time to time when it is appropriate to augment a member's benefits on the basis described above. It is, however, possible for a member's benefits to be increased to the detriment of other members of the fund while, for example, the employer enjoyed a tax deduction on the basis that his contributions would be for the benefit of all the members. To prohibit a member or group of members from benefiting in such a way, it has become necessary for the following requirements to be met for an augmentation to take place:

1. If it is desired to provide for the augmentation of members benefits, the rules of the fund must provide therefor.
2. Where the proposed increase in the cost (to the fund) of the benefits is more than ten per cent of the total cost of the benefits otherwise payable to the member in terms of the rules of the fund, the increased benefit may not be paid to the member unless this office has approved the payment. The application for approval must contain the information requested in Annexure A. This office will request further information if necessary and will only consider an application if it is satisfied that the provisions of section 11(l) of the Income Tax Act have been met where applicable.
3. Where the rules of the fund make provision for a reserve or similar account, the cost of the augmentation may only be taken from that account. Should the amount in the reserve or similar account be insufficient to fund the proposed increase, the additional cost must be met by payment by the employer or member of an additional amount, equal to the additional cost, into the reserve or similar account.
4. Where an additional amount is paid into the fund by the employer (whether into a reserve or similar account) in order to meet the cost of the increase in the benefit, the employer must, when submitting his income tax return, advise the Receiver of Revenue of the payment and provide the information needed in terms of section 11(l) of the Income Tax Act.
5. Contributions by an employer to a reserve or similar account in an approved fund which are not made in the circumstances described in paragraph 3 above will not be regarded as having been made for the benefit of the employees of the employer as contemplated by section 11(l) of the Act and will, as a result, not be allowed as a deduction in terms of section 11(l) of the Act. Employers must advise their Receiver of Revenue of the amount of such contributions when they are made.

This office is aware of practices in defined benefit funds whereby fund salary is substantially increased just before retirement but which do not entail an actual increase in salary and which lead to an increased benefit funded by reserves. Such practices are unacceptable and will jeopardise the continued approval of the fund for income tax purposes.

The requirements of this practice note are applicable with immediate effect to all approved pension and provident funds, whether or not a reserve or similar account is maintained.

ISSUED BY THE OFFICE OF THE COMMISSIONER FOR INLAND REVENUE
16 October 1995

ANNEXURE A

The following information must be submitted on application for approval of an augmented benefit:

1. The name of the fund.
2. This office's reference number for the fund.
3. The name of the member.
4. His/her date of birth.
5. The position held with employer.
6. The date on which the benefit becomes due.
7. The date the member joined the fund.

8. The length of pensionable service.
9. The benefit before increase.
10. The benefit after the proposed increase.
11. The reason(s) for the increase.
12. How the amount of increase is arrived at.
13. How the cost of the increase is to be funded.
14. The number of members in the fund immediately prior to the augmentation.
15. The effect of the increase on the remaining members.
16. Whether the number of members in the fund has decreased during the period of 12 months prior to the augmentation. If so, why?
17. Whether the fund has been, or is about to be, terminated.
18. Whether the augmentation has been approved by the trustees, governing body or administrators of the fund and been recommended by the fund's actuary.