

*SOUTH AFRICAN REVENUE SERVICE*

**BINDING CLASS RULING: BCR 007**

DATE: 16 October 2009

**ACT : INCOME TAX ACT, NO. 58 OF 1962 (the Act)**  
**SECTION : SECTION 1 DEFINITION OF “PENSION FUND” AND  
“GROSS INCOME” AND PARAGRAPHS 1, 2 AND 2A OF  
THE SECOND SCHEDULE TO THE ACT**  
**SUBJECT : CONVERSION OF TWO PUBLIC SECTOR PENSION FUNDS  
TO A CLOSED DEFINED BENEFIT FUND AND A DEFINED  
CONTRIBUTION FUND RESPECTIVELY**

**1. Summary**

This ruling deals with the conversion of two public sector pension funds to a closed defined benefit pension fund and a defined contribution fund respectively and whether the conversion will affect the status of these funds as a pension fund as defined in paragraph (a) of the definition of “pension fund” in section 1 of the Act. The ruling also looks at the transfer of members’ interests between the funds and related tax implications for the members.

**2. Relevant tax laws**

This is a binding class ruling issued in accordance with section 76R of the Act.

In this ruling legislative references to sections and paragraphs are to sections of the Act and paragraphs of the Second Schedule to the Act applicable as at 27 October 2008 and unless the context indicates otherwise, any word or expression in this ruling bears the meaning ascribed to it in the Act.

This ruling has been requested under the provisions of –

- section 1, the definition of “pension fund” and “gross income”; and
- paragraphs 1, 2 and 2A of the Second Schedule.

### **3. Class**

The class members to whom this ruling will apply will be the members of the two pension funds to be converted to a closed defined benefit fund and a defined contribution fund respectively.

### **4. Parties to the proposed transaction**

The Applicants: Two public sector pension funds, (both regulated by the Pension Funds Act, No. 24 of 1956) and established for the benefit of the employees of a South African Public Institution on behalf of the members

The Institution: A South African Public Institution

### **5. Description of the proposed transaction**

The Applicants (Fund A and Fund B), were established at the time for the benefit of employees of a public institution. Each fund has as its object the provision of pension benefits for its members (which includes pensioners) and dependants, heirs and the estate of members.

Currently the Applicants provide pension benefits for the employees and pensioners of the Institution as well as for the employees and pensioners of a number of the Institution's legal entities. The Institution exercises ownership control over these legal entities and all the employees of these entities, who are members of the Applicants, were employees of the Institution immediately prior to becoming employees of one of these entities.

It is proposed to amend the rules of these funds and in terms of the proposals –

- Fund A will function as a closed defined benefit fund securing the past service benefits of retired members and active members of both Fund A and Fund B prior to the implementation of the proposed amendments; and
- Fund B will become a defined contribution fund.

From the effective date of the implementation of these proposed amendments all active members of these funds will become members of Fund B, and all subsequent contributions to secure future benefits will be paid to Fund B only.

Active members of both of these funds will then have a choice as to which fund they would prefer to preserve their accrued rights in. Either Fund A or Fund B. Depending on the choice that is exercised this will entail the movement of accrued rights from Fund A to Fund B or *vice versa*.

The following facts are relevant insofar as the application of paragraph (eA) of the definition of “gross income” is concerned:

- The members of Fund A and Fund B will ‘effectively’ remain in the employment of the same employer namely the Public Institution or one of its legal entities.
- The current rules of both Fund A and Fund B stipulate that on retirement of a member a portion of the member’s benefit has to be taken in the form of an annuity.
- The rules of Fund A have been extended to entitle members of Fund B, who transfer their accrued rights to Fund A to be preserved, to a benefit on retirement in the form of a lump-sum not exceeding one-third of the capitalised value of all benefits.
- The current and proposed rules of Fund B provide for members that transfer funds to Fund B to be entitled to a benefit on retirement in the form of a lump sum that does not exceed one-third of the capitalised value of all benefits.

## **6. Conditions and assumptions**

This ruling is not subject to any conditions and assumptions.

## **7. Ruling**

The ruling made in connection with the proposed transaction is as follows:

- The implementation of the proposed rule amendments for each of the funds will not affect the status of either Fund A or Fund B as a pension fund, as contemplated in paragraph (a) of the definition of a “pension fund” in section 1.
- Paragraphs (b)(i) and (c)(i) of the definition of “formula C” in paragraph 1 of the Second Schedule will be applicable in calculating the taxable portion of the retiring benefit payable by Fund A to any of its members.
- The member’s total number of completed years of employment up to the date of the member’s retirement from Fund A must be taken into account for purposes of paragraph (c)(i) of the definition of the term “formula C” in paragraph 1 of the Second Schedule.

- Paragraphs (b)(ii) and (c)(ii) of the definition of “formula C” in paragraph 1 of the Second Schedule will be applicable in calculating the taxable portion of the retirement benefit payable by Fund B to any of its members.
- The wording “continuously been a member of any public sector fund” in paragraph (c)(ii) of the definition of “formula C” in paragraph 1 of the Second Schedule does not include membership years bought back.
- A transfer of funds from Fund B to Fund A will not attract any tax consequences under paragraph (eA)(i) of the definition of the term “gross income” in section 1.
- A transfer of funds from Fund A to Fund B will not attract any tax consequences under paragraph (eA)(i) of the definition of the term “gross income” in section 1.
- The proposed rule amendments will not constitute a conversion of either Fund A or Fund B in the sense contemplated in paragraph (eA)(ii) of the definition of the term “gross income” in section 1 and will not attract any tax consequences under that paragraph.

**8. Period for which this ruling is valid**

This binding class ruling is valid for a period of five (5) years as from the date of this ruling until 26 October 2013.

Issued by:

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