momentum

ASAP

Legal and Technical Update

Government Employee Pension Fund (GEPF)

This document provides a summary of the GEPF Law, the GEPF member's guide and the tax legislation applicable to the fund benefits. It is not a summary of all the rules and should not be consulted in isolation, but rather with the member's statement and also in consultation with the fund. It is not intended to be advice and is presented for information purposes only.

The GEPF is the retirement fund to which many government employees belong. This is a defined benefit fund which means that the benefits are determined in terms of the rules of the fund and are dependent on the duration of membership (referred to pensionable service), the final salary of the member concerned and the member's age. It is not based on the actual contributions made by the member and/or the employer or the investment returns achieved on the contributions which results in the investment risk being borne by the fund.

Resignation

The benefits apply to members who resign or are discharged due to misconduct or an illness or injury caused by the member's own doing. These members have two options:

- Be paid a gratuity (a once-off lump sum) which may be subject to income tax; **OR**
- Transfer their benefits to an approved retirement fund. If benefits are being transferred, the GEPF pays the member's actuarial interest to the member's new fund. The amount that is transferred to an approved retirement fund is not taxed at this point and tax is only deducted when the member retires or withdraws and receives a lump sum from the new fund.

The member cannot select a combination of the two options – it is the one or the other.

Note:
- From 1 April 2012 members are entitled to a resignation benefit that is the larger of either the lump sum resignation benefit or the member's actuarial interest, irrespective of whether the member chooses to transfer to an approved retirement fund or not.
- On resignation the member loses his/her leave pay lump sum as well as any post-retirement medical aid benefits. Therefore it is imperative to keep this in mind when a client is weighing up resignation from the fund.

What is an approved retirement fund?
An approved retirement fund will either be a pension fund linked to a new employer, a retirement annuity fund or a pension preservation fund (even though the GEPF Law does not specify preservation funds, transfers are allowed to take place between the GEPF and preservation funds). The approved fund has to abide by the restrictions imposed by the GEPF Law.

When a transfer is contemplated, one must take note of the restriction imposed by the GEPF Law regarding accessibility to the funds, prior to retirement and at retirement. The wording in the GEPF Law is as follows:

Such transfer shall be made subject to the rules of the approved retirement fund specifying that, with reference to the transfer benefit, <u>any subsequent lump sum benefit payable by that fund or any successor fund to the member and/or his beneficiaries shall be limited to one third of the said transfer benefit, with interest</u>. The balance of the member's transfer benefit with interest, after deduction of any lump sum payment referred to above, shall be applied for the purchase of an annuity, albeit immediately or upon the member's ultimate retirement.

There are different interpretations of the rule. However, it is clear that the member may not receive more than one third of the transfer value plus interest. In the case of a pension preservation fund, this restriction must be noted if a member wants to take a pre-retirement withdrawal. Any lump sum amount withdrawn from the preservation fund prior to retirement will therefore impact the ability to receive another lump sum at retirement.

Retirement

The GEPF provides for normal, early and late retirement, as well as retirement for medical (ill health) reasons. Where a member's position is affected by restructuring or reorganization (retrenchment), they are also entitled to receive retirement benefits.

Normal retirement:
The normal retirement age for most members of the GEPF is 60 (in terms of the Public Services Act); however the laws governing that specific employee's employment can prescribe a different retirement age. Once a member has attained this prescribed age, he/she cannot choose to resign instead of retire.

The benefits paid depend on whether a member has less than 10 years' pensionable service, or 10 or more years of pensionable service at retirement. Members with less than 10 years' service receive a gratuity (a once-off lump sum) that is equal to their actuarial interest in the fund. Members with 10 or more years' service receive a gratuity and a monthly pension (annuity). In this instance the member does not have a choice in the matter. There is no option to transfer the capital funding the annuity income to another compulsory annuity fund.

Early retirement
Under certain circumstances, members may retire early, meaning before reaching the normal retirement age. The Public Services Act determines that members may retire early between the ages of 55 and 60; however, it will be subject to penalties.

The member's years of pensionable service will once again assist in determining the benefits. Members with 10 or more years of service receive annuities and gratuities. These are calculated in the same way as for normal retirement, but with a reduction (the penalty) of a third of one percent (0.33%) for each month between the dates of early retirement and normal retirement.

Special early retirement allowance until 30 September 2019
During the 2019 Budget Speech a proposal was made to assist government to manage their expenses, i.e. their salary bill. It allows for an opportunity for certain members nearing retirement to retire early without incurring any penalties. A circular was published in March to provide details and guidelines.

This option is only available to employees between the ages of 55 and 59. It applies to all employees employed in terms of the Public Services Act as well as members of services (includes the National Defense Force, SAP and Department of Correctional Services), educators and members of the intelligence service.

(Note – See the ASAP dealing with the Early Retirement Offer.)

Ill health and other retirements
Enhanced benefits are paid when members retire for medical reasons, when injured on duty, or when their positions are abolished through organisational restructuring. In these circumstances, members receive both annuities and gratuities.

For members with less than 10 years' pensionable service, benefits are based on an increased period of service and calculated as a percentage of the member's final salary. Members with more than 10 years' service are also paid an annual supplementary amount.

Is it possible for a retiring member from the GEPF to purchase a living annuity?
No, once a member reaches retirement age, the fund rules will apply. The implication of this is that if the member has less than 10 year service, only a lump sum amount will be payable, and if he / she has more than 10 year service, a combination of a lump sum and a monthly pension will be payable. The monthly pension will be payable by the fund and the member cannot transfer the amount funding the annuity income to a living annuity outside the GEPF.

If the member would like to purchase a living annuity to provide post-retirement income, the only option will be for the member to resign prior to retirement. As mentioned above, resignation vs retirement can have far-reaching implications as it can result in leave pay and also post-retirement medical scheme benefits being lost. Therefore it is not a decision that should be taken lightly.

If however a decision is made to resign, it has to take place before the member reaches the retirement age and the member has to transfer the resignation benefit to another approved retirement fund – either a pension preservation fund or a retirement annuity fund. Once the member is in that fund and is over the age of 55, the member can elect to retire from the fund and then purchase the living annuity.

Additional benefits when retiring
When a member retires from the GEPF, the following benefits become relevant in addition to the retirement benefit:

- Pro-rata service bonus – this is basically equal to one month's salary and then adjusted downwards for each month in the year that the employee will not be working;
- Leave pay – compensation for unused leave days;
- Compensation for medical assistance (post-retirement medical benefit) – this is based on the number or pensionable service years and the years member to a medical scheme. Different compensation amounts apply depending on year's membership (either more or less than 15 years). Where years' service is less than 15 years, a lump sum amount will be payable. Where the years' service exceeds 15 years, a portion of the medical scheme contribution will be paid by the government for the rest of the member's life.
- Housing allowance – employees linked to the Government Employee Housing Scheme (GEHS) or the Individual-Linked Savings Facility (ILSF) will be entitled to their accumulated savings;
- Resettlement costs that may apply to retiring employees.

Death

Death benefits are paid when a member dies while in service, or within five years of becoming a pensioner. The GEPF also pays annuities to the surviving spouse(s) or orphan(s)* of members who die while in service or after retiring.

Death while in service
The benefit paid is based on the member's period of pensionable service. It is payable to the surviving spouse or beneficiaries or, if there are no beneficiaries, to the member's estate.

Death after becoming a pensioner
Retirement or discharge annuities are guaranteed for five years after a member goes on pension. If the member dies within this period, his or her beneficiaries receive the balance of the five-year annuity payments (excluding the annual supplement) paid as a once-off cash lump sum.

Spouse's pension
A spouse is entitled to a percentage of the annuity paid to the member at date of death. The same applies if the member dies while in service and had a full potential service period of at least 10 years (meaning pensionable service years plus unexpired years until normal retirement). A spouse is defined by the GEPF Law as a person who is:

- a lawful husband or wife; or
- a life partner (including same sex life partner); or
- a husband or wife in terms of the Recognition of Customary Marriages Act or the tenets of any religion,

of the member or pensioner at the date of the member's or pensioner's death. Provided that a member or pensioner should register with the Fund his or her spouse and that such registration will be prima facie proof of being a spouse. However, where a person is not registered, that person may provide proof to the satisfaction of the Board that he or she is a spouse.

Child's annuity
GEPF pays annuities to the eligible children of members who became pensioners on or after 1 December 2002. It is also payable when a member dies in service with a potential service period of 10 years or more.

An eligible child is a natural or adoptive child of a member who is alive and under the age of 18, or is under the age of 22 and in the opinion of the Board a full time student, or is a child over 18 that are disabled and dependent on the member.

Where there is no spouse or child, the benefits will not apply.

Divorce

The GEPF introduced the clean-break principle with effect from 1 April 2012.

In order for the GEPF to deduct money from a member's pension benefit, the divorce order must comply with the Divorce Act. Also, the decree of divorce must be issued as a valid court order specifically granting the former spouse a share of the member's pension interest. The right to a portion of the member's pension interest is not automatic.

Current treatment of a divorce settlement
The payment of a divorce benefit to a non-member spouse in terms of a divorce order will result in a debt being created against the member's fund benefit (debt and interest model). This debt is equal to the amount paid to the non-member spouse and it will build up, with interest, up until the member exits the fund.

Amended treatment of a divorce settlement
The GEPF Law has been amended on 23 May 2019 and once implemented it will bring an end to this divorce debt being created. Instead, the payment of a divorce benefit to a non-member spouse will result in a reduction of the member's years of pensionable service (remember the year's pensionable service has a direct impact on the benefit that the member is entitled to). This is being referred to as the service reduction model.

The change will be implemented on 1 August 2019. Members that currently have divorce debt will have a choice of either remaining with the debt and interest model or to move to the service adjustment model. They will have until 22 May 2020 to make their choice, after which all those members that did not make a selection will automatically be moved to the service reduction model. The tax implications of the implementation of the clean-break principle are as follows:

- No tax will be payable on any amount that becomes payable on or after 1 March 2012 in terms of a divorce order that was issued before 13 September 2007.
- If an amount becomes payable by a retirement fund on or after 1 March 2012 to a non-member ex-spouse, that person (and not the member ex-spouse) will need to pay tax on that amount. Any pre-1998 tax-free benefit will accrue proportionately to the non-member spouse.

Pre-1998 tax-free portion

Paragraph 2A of the Second Schedule

As all public sector retirement funds were tax exempt until 1998, all benefits that accrued in the fund up until that time will remain tax-free and only the benefits that accrued thereafter could be subject to tax when the member received a lump sum due to resignation, retirement or any other reason (also in the case of divorce as indicated above).

The Second Schedule to the Income Tax Act prescribes the formula to use when determining the taxable portion of any lump sum. It is as follows:

A = B/C x D
A = amount to be determined, which is the taxable amount
B = number of completed years member of the fund after 1 March 1998
C = number of completed years member of the fund
D = lump sum amount

It is important to note that D is the lump sum amount that accrues to the member. When a member resigns from the fund, the full resignation benefit accrues to the member and therefore this formula is applied to that full benefit amount. If the member transfers the resignation benefit to another approved retirement fund, the tax-free portion will follow to the transferred fund. The result is that if the member makes a withdrawal from that fund or retires from that fund anytime in the future, that tax-free portion will remain and be considered when calculating the taxable lump sum.

The rules pertaining to the tax-free benefit following a fund transfer has evolved over time. The time line is as follows:

Date of transferred to approved fund	Retention of pre-98 tax-free benefit
Pre - 2006	The pre-98 benefit is lost upon transfer to another approved fund
2006 - 2009	The pre-98 benefit remained intact upon the transfer from the GEPF to the approved fund, which at that time was limited to another pension fund or a RA
2009 – 2018	The pre-98 benefit remained intact upon the transfer from the GEPF to an approved fund, which includes another pension fund, pension preservation fund or a RA
1 March 2018	The pre-98 benefit remains intact upon transfer from the GEPF to an approved fund and also for one other transfer – so two transfers and an approved fund includes another pension fund, pension preservation fund or a RA

The following example will illustrate this application of this formula:

Resignation and subsequent transfer

Let's assume the member joined the GEPF in 1980. He is resigning now with a benefit amount of R5 000 000 and is transferring the benefit to a pension preservation fund.

When applying the formula, the taxable portion of this amount is determined as follows:

A	=	B/C x D
	=	21/39 x R5 000 000
	=	R2 692 307

Therefore the tax-free portion is equal to R5 000 000 – R2 692 307 = R2 307 693.

Upon the transfer to the preservation fund, this tax-free amount will remain effective.

Assuming the members takes a withdrawal from the preservation fund equal to one third of the transfer value, it will be equal to R1 666 667. When determining the taxable portion of this lump sum, the tax-free portion that was transferred across to the fund will be available as a deduction against this lump sum. Therefore the total withdrawal amount will be tax-free. The remaining R641 026 tax-free portion will remain available insofar the member is entitled to a lump sum upon retirement. Should the lump sum amount exceed the tax-free portion available, that surplus would be taxed in terms of the withdrawal tax table.

As mentioned, in terms of current legislation, the tax-free portion would remain available for a total of two transfers. Example:

✓	Transfer 1	-	GEPF to new employer's pension fund
✓	Transfer 2	-	Employer pension fund to pension preservation fund
X	Transfer 3	-	Pension preservation fund with company A to company B
		-	Benefit is lost.

Retirement and the tax-free portion

Assuming the member used in the previous example is retiring. His retirement benefit lump sum is equal to R1 666 667 and he will be entitled to a pension payable by the fund for his lifetime.

The formula is now applied to the lump sum that accrues to him, which is R1 666 667. The result is that the taxable portion is as follows:

A	=	B/C x D
	=	21/39 x R1 666 667
	=	R897 436

This amount will now be taxable in terms of the retirement tax table which can result in an additional R500 000 being tax-free (depending on whether the member received any other retirement fund lump sums).

NOTE – any tax-free portion that is not used when receiving a lump sum from the fund or the subsequent approved fund will be lost. It will not be available as an exemption against the monthly pension.