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ASAP

Legal and Technical Update

Approved vs. Unapproved Group Life

Many employees enjoy some form of group life benefit. The benefits generally include life cover and disability benefits, income and/or lump sum disability and some group life benefits also include critical illness as well. This article focuses on the death benefit.

When doing an estate plan it is vital to ascertain whether the group life benefits are approved or unapproved, as this will have a direct impact on the income tax and estate duty consequences on the pay-out. If this is ignored it can leave a serious shortfall in the provisions made.

Approved Group Life Schemes

If a group life benefit is offered in terms of the rules of an approved pension or provident fund, it is referred to as an approved scheme. The owner of the group life policy is the retirement fund, the fund pays the premium (which is funded by member contributions made to the fund) and the fund will receive the proceeds payable upon the death of the member.

The death benefit payable by the fund will consist of the investment value in the fund plus the death benefit payable by the group life policy. The trustees of the fund will pay the benefits in terms of section 37C of the Pension Funds Act. Therefore it will firstly be payable to the dependents (as defined) or the beneficiaries or a combination of the two. Where no dependent or beneficiary exist, it will be payable to the estate of the deceased.

Income Tax Implications - contribution

The total contributions paid to the retirement fund by the member will be tax deductible in terms of section 11F of the Income Tax Act.

Therefore the contribution, which includes the group life contribution, is tax deductible within the prescribed limits and is limited to the lesser of R350 000, or 27.5% of the greater of taxable income or remuneration, or taxable income (excl capital gains).

Income Tax Implications – proceeds

Upon the death of the member the dependents/beneficiaries will have the option of taking the death benefit as a lump sum or to transfer it to a compulsory annuity or a combination of the two. (The death benefit is made up of the investment value in the fund and the proceeds from the approved group life policy.)

Where a lump sum is selected, it is deemed that the lump sum was received by the deceased the day immediately prior to death and therefore taxable in the hands of the deceased. The table applicable to retirement/death will apply and all prior retirement fund lump sums received by the deceased will be taken into account when determining the tax payable.

The amount transferred to the compulsory annuity will not be subject to tax, however, the income paid by the annuity will be fully taxable in the hands of the dependent/beneficiary.

Estate Duty Implications

In terms of section 3(2)(i) of the Estate Duty Act, death benefits payable by an approved fund will be exempt from estate duty.

Unapproved Group Life Schemes

Unapproved group life schemes refer to death benefits provided under an insurance contract that exists separate from any retirement fund. In general the employer takes out an insurance contract on the life of the employee. If a beneficiary is noted on the policy the death benefit will be paid to that beneficiary directly. Where no beneficiary is nominated the proceeds will be payable to the employer (as the policyholder) and the employer will then pay it to the estate of the employee.

The Pension Fund Act does not apply to this group life benefit and therefore section 37C is not applicable.

Income Tax Implications - contributions

Where the employer contributes to the unapproved policy on behalf of the employee, Section 11(w)(i) of the Income Tax Act will apply.

Therefore, the employer will enjoy a tax deduction in respect of the contribution made on behalf of the employee, on condition that this amount is included in the employee's gross income as a fringe benefit. Therefore the employee will pay income tax on the contribution made.

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Income Tax Implications - proceeds

Upon the death of the employee, the policy proceeds will pay out to the employer – or it is paid directly to the nominated beneficiary if one was noted on the policy. The employer will be tax neutral in respect of the proceeds (it is included in the gross income of the employer, however, it is tax deductible as it is paid to an employee/employee's beneficiary.)

The proceeds will be included in the gross income of the employee, however, an exemption will apply in terms of section 10(1)(gG) if all contributions were included in the employee's income as a fringe benefit.

Estate Duty Implications

This benefit is funded by a long term insurance policy on the life of an employee and therefore section 3(3)(a) of the Estate Duty Act will apply.

This determines that any policy that pays out due to the death of a person (so where he/she is the life insured), the proceeds will be a deemed asset in the estate of the deceased for estate duty purposes.

Should the benefit be payable to the employee's spouse, section 4(q) will allow for a deduction neutralising the estate duty.

Conclusion

It is clear that the difference between an approved and unapproved fund cannot be ignored as it can and will have a major impact on the after tax outcome of the benefit.

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