ASAP

Legal and Technical Update

Section 10C of the Income Tax Act

This section of the Act defines a compulsory annuity as the remainder of the retirement interest of a person payable in the form of an annuity as provided for in the definition of pension fund, retirement annuity fund and pension preservation fund. Based on the wording of the definition of compulsory annuity contained in section 10C, it does not include an annuity as provided for in paragraph (a) and (b) of the definition of a pension fund or an annuity forthcoming from a provident or provident preservation fund.

It furthermore provides for an exemption in respect of all disallowed contributions to be applied against the aggregate of compulsory annuities payable to a person, that was not applied as-

a) a deduction in terms of the Second Schedule against retirement fund lump sums; or
b) an exemption from normal tax in terms of this section, in respect of any year of assessment.

This section is applicable from 1 March 2014 and applies in respect of amounts received or accrued on or after that date.

Practical implications

When considering the impact of this section one has to remember that the Second Schedule of the Income Tax Act provides for a deduction against a lump sum received from a retirement fund equal to the sum of all contributions that were not allowed as a tax deduction previously. Therefore reading section 10C with the Second Schedule, any aggregate of a person’s own contributions to a retirement fund that did not rank for a tax deduction against that person’s income, shall:

- Firstly, be deducted against any retirement fund lump sum, and
- Any remaining amount can then be applied in respect of the aggregate of compulsory annuities payable to a person during any year of assessment.

This benefit is only available to the person that actually made the contributions to the fund and will not be carried forward to a beneficiary of an annuity upon the death of that person.

Example:

Peter (55) received a hefty inheritance of R5 000 000 from a great aunt. He decides to invest this amount in a retirement annuity. During that tax year, Peter claims the R5 000 000 as a retirement fund contribution of which R350 000 is allowed as a deduction. Therefore disallowed contribution that rolled over to the following year is R4 650 000. That following tax year Peter is in a major accident and as a result he decides to retire from the retirement annuity. Peter has quite a bit of unpaid medical bills and has to access a portion of his retirement annuity as a lump sum. He takes a lump sum of R1 000 000 and transfers the rest of the benefit to a living annuity. His living annuity income is R500 000 per annum (assume this income remains unchanged for the duration of his lifetime).

Tax on lump sum = nil

R1 000 000 less R4 650 000 disallowed contribution = R0 taxable lump sum

Tax on income = nil for 7.3 years

The remaining R3 650 000 disallowed contributions will be offset against the income earned, in terms of section 10C