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Please quote our reference: **PFA/WE/1680/2010/EMD**

**REGISTERD POST**

Dear Sir,

**DETERMINATION IN TERMS OF SECTION 30M OF THE PENSION FUNDS ACT NO. 24 OF 1956 (“the Act”): P DE LEEUW DEN BOUTER (“complainant”) v CAPE RETIREMENT FUND FOR LOCAL GOVERNMENT (PREVIOUSLY KNOWN AS CAPE JOINT RETIREMENT FUND) (“first respondent”) AND VERSO FINANCIAL SERVICES (PTY) LTD (“second respondent”)**

**[1] INTRODUCTION**

- 1.1 The complaint concerns the calculation of the tax-free portion of a retirement benefit.
- 1.2 The complaint was received by this Tribunal on 19 August 2010 from the Office of the Ombud for Financial Services Providers. A letter acknowledging receipt thereof was sent to the complainant on 14 September 2010. On the same date, letters were dispatched to the respondents giving them until 27 October 2010 to file responses. A response, a copy of which was forwarded to the complainant, was received on 26 October 2010. No further submissions were received.

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The Office of the Pension Funds Adjudicator was established in terms of Section 30B of the Pension Funds Act, 24 of 1956. The service offered by the Pension Funds Adjudicator is free to members of the public.

**Centralised Complaints Helpline for All Financial Ombud Schemes 0860 OMBUDS (086 066 2837)**

1.3 Having considered the written submissions before this Tribunal, it is considered unnecessary to hold a hearing in this matter. As the background facts are well-known to the parties, only those facts that are pertinent to the issues raised herein will be repeated. The determination and reasons therefor appear below.

**[2] FACTUAL BACKGROUND**

2.1 The complainant retired on 31 March 2010. He requested payment of the maximum tax-free portion of his retirement benefit in cash with the balance being utilised to purchase a living annuity.

**[3] COMPLAINT**

3.1 The complainant submits that he was paid 25% of his retirement benefit in cash whereas, according to a submission by the second respondent made prior to his retirement, he would be entitled to 52% in cash as the maximum tax-free portion.

3.2 The complainant wishes to access the maximum tax-free portion of his retirement benefit, as he wishes to manage this himself.

**[4] RESPONSE**

4.1 The respondents submitted that the name of the first respondent had changed to the Cape Retirement Fund for Local Government.

4.2 The complainant retired from the first respondent on 31 March 2010.

4.3 The first respondent is recognised as a paragraph (a) pension fund (“paragraph (a) fund”) as contained in the definition of *pension fund* in the Income Tax Act No. 58 of 1962 (“ITA”).

- 4.4 Prior to his retirement, the complainant consulted with a representative of the second respondent, who prepared a document setting out various options available to him.
- 4.5 Option 1 sets out the tax implications, should the member have elected to take the full benefit in cash. With effect from 1 March 1998, benefits payable by paragraph (a) pension funds (i.e. public sector and municipal pension funds) became taxable to ensure equity in benefits paid by paragraph (a) and certain other pension funds. As such the tax formula “C” was introduced in the ITA in order to preserve the vested tax-free portion of the benefit that had accrued up to 1 March 1998. This calculation ultimately determines the amount of the benefit, which is required to be taken into account in determining the taxable benefit as determined by paragraph (e) of the definition of *gross income* as defined in the ITA.
- 4.6 Formula “C” as contained in the Second Schedule of the ITA, in relation to any paragraph (a) fund, means the formula:

$$A = B/C \times D$$

where

A = amount to be determined;

B = number of completed years of employment after 1 March 1998;

C = number of completed years of pensionable service;

D = lump sum benefit payable to the taxpayer.

- 4.7 In the case of the complainant, formula “C” is calculated as follows:

$A = 12/25 \times R2\,538\,267.00 = R1\,218\,368.00$ . This is the taxable benefit. The balance of the benefit, R1 319 899.00, represented the tax-free portion of the benefit. The lump-sum benefit used in this calculation did not include the final contributions to the first respondent.

- 4.8 The complainant had other investments, which were also taken into account and the full tax implications were discussed in the document.
- 4.9 The standard taxation tables on retirement were amended with effect from 1 March 2009 where the first R300 000.00 of the retirement benefit was tax-free, R300 000.00 to R600 000.00 was taxed at 18%, R600 000.00 to R900 000.00 was taxed at 27% and benefits exceeding R900 000.00 were taxed at 36%. In addition, where a member belonged to a paragraph (a) fund, the tax formula “C” also had to be applied to determine the taxable benefit.
- 4.10 Option 2 considered the situation if a member was to take part cash and partly invest the balance of the benefit in an annuity. The tax formula “C” was reversed to establish the tax-free benefit. Taking into account the amended tax tables, the following calculation was prepared:

Up to R300 000	Nil
R300 000 to R600 000	R54 000
R600 000 to R900 000	<u>R81 000</u>
Total tax	<u>R135 000</u>

- 4.11 The complainant was due to receive a cash benefit of R30 000.00 from a different source, so this amount was deducted from the R900 000.00 to arrive at a taxable fund benefit of R870 000.00.
- 4.12 On 15 June 2010, the first respondent received the complainant’s retirement claim form and supporting documents. The complainant instructed the first respondent to pay the maximum tax-free benefits to him with the balance being utilised to purchase a living annuity. The complainant requested the first respondent to calculate the relevant maximum tax-free benefit. He was no longer using the services of the

second respondent to attend to his financial planning.

- 4.13 The first respondent recalculated the retirement benefit, which now amounted to R2 606 720.93. Assuming the complainant were to take the full lump sum benefit as a cash lump sum, the total benefit that would attract tax amounted to R951 226.05.
- 4.14 Assuming the complainant were to take the tax-free portion of the benefit as a cash lump sum and purchase an annuity with the remaining portion, a different scenario is created as the taxable portion of the benefit will differ in the case of the value of the actual lump sum benefit (as defined in the ITA) changing.
- 4.15 According to the tax tables applicable to the Second Schedule of the ITA, the first R300 000.00 of the retirement benefit is tax-free on condition that the member has not utilised this tax-free benefit previously.
- 4.16 The tax implications in this scenario can be calculated as follows:

Formula "C":  $12/25 \times R2\ 606\ 720.93 = R1\ 251\ 226.05$  (taxable portion).

In order for nil tax to be payable, formula "C" must equal the tax-free lump sum of R300 000 and therefore a reverse calculation must be applied as follows:

$R300\ 000 \times 25/12$	=	R625 000 (maximum tax-free lump sum benefit)
$12/25 \times R625\ 000$	=	R300 000 (tax-free benefit in terms of the Second Schedule of the ITA)

This calculation results in the following:

Maximum tax-free cash lump sum benefit	=	R 625 000.00
Balance to be utilised to purchase an annuity	=	<u>R1 981 720.93</u>
Total retirement benefit	=	<u>R2 606 720.93</u>

- 4.17 As many financial planners were not familiar with the reverse calculation

to determine the tax-free benefit when applying the tax formula “C”, the first respondent obtained a Declaratory Order from the South African Revenue Services (“SARS”).

- 4.18 Despite the fact that this Order took into account the previous tax dispensation which contained the tax formulas “A” and “B”, the reverse tax calculation to achieve the matching of the new standard tax-free amount of R300 000.00 (on retirement) remains unchanged.
- 4.19 The financial advice given to the complainant by the second respondent took into account various scenarios together with other investments which the complainant had.
- 4.20 The complainant’s reference in his complaint to the tax-free calculation according to formula “C” representing 52% of his benefit, related solely to him receiving a full cash benefit. At his retirement, the complainant requested that he receive the maximum tax-free amount as a cash benefit and the balance was to be invested in a living annuity. This necessitated a recalculation of the tax formula “C”, which was now required to be equal to the standard tax-free amount of R300 000.00 and hence the reduction in the amount available as a tax-free benefit.
- 4.21 The first respondent applied for tax clearance from SARS on the basis as contained in the ITA and the SARS Declaratory Order and received the appropriate nil tax directive for the payment of the lump sum tax-free benefit.
- 4.22 The respondents submitted that from the complaint it appears that the complainant had not been advised by his new financial planner of the various implications of the tax formula “C” in the event of either taking a full cash lump sum, or taking the maximum tax-free cash lump sum and

purchasing a Living Annuity with the balance of the benefit.

**[5] DETERMINATION AND REASONS THEREFOR**

- 5.1 The issue that falls for determination is whether or not the tax-free cash amount paid to the complainant by the first respondent when he retired was correctly calculated. Should this investigation show that the calculation was incorrect and that there was any negligence by the first or second respondents, the complainant should be put in a position he would have been had the first and second respondents complied with their duties in ensuring that the maximum tax-free amount was paid to him upon retirement.
- 5.2 The complainant was a member of the first respondent, a so-called municipal pension fund, which offered certain tax benefits in respect of benefits that had accrued up to 1 March 1998. The calculation of the maximum tax-free portion of the benefit depended *inter alia* on the complainant's other investments, on whether the whole benefit was to be taken in cash, and whether a part of the benefit would be used to purchase an annuity.
- 5.3 The respondents have given a detailed explanation of how the complainant's maximum tax-free benefit was calculated. In addition, the respondents obtained a Declaratory Order from SARS about the manner of calculation of the tax-free portion. Nothing has been placed before this Tribunal to show that the calculation of the tax-free portion of the complainant's benefit was not correct.

**[6] ORDER**

1. In the result, the complaint cannot succeed and is hereby dismissed.

**DATED AT JOHANNESBURG ON THIS 20<sup>th</sup> DAY OF NOVEMBER 2012**

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**MA LUKHAIMANE**  
**DEPUTY PENSION FUNDS ADJUDICATOR**

**Section 30M Filing: Magistrate's Court**  
*Parties unrepresented*