Clean break to be applied to tax on divorcee pension benefits

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By Laura du Preez

The Income Tax Act is to be amended later this year to ensure that in most cases divorcees who receive a portion of their former spouse's retirement fund benefits will pay the tax due on these benefits regardless of when the benefits are paid out and whether a fund has introduced the clean-break principle in its rules, National Treasury says.

In a recently released media statement, treasury outlines the amendments to the Income Tax Act that it plans to introduce and which will take effect retrospectively from March 1 this year.

The tax bill introducing the amendments has yet to be published for comment, but in its statement treasury says government's policy is to promote the "clean-break" principle when it comes to taxing retirement benefits split in terms of a divorce order.

It says this means each party to a divorce order should be subject to tax on the portion of the pension interest each receives.

Tax law amendments introduced in 2009 made non-member former spouses liable for any tax due on their portion of a pension interest awarded in terms of divorce orders issued after the clean-break principle for private-sector retirement fund benefits was introduced.

However, treasury says sometimes the non-member former spouse fails to claim payment of the divorce award from a retirement fund before the member leaves the fund.

This may happen where, for example, a non-member former spouse notifies the retirement fund of the divorce order, but fails to elect to receive the payout of the pension interest.

In this case, the member may be held liable for the tax on the full benefit paid from the fund, instead of only the portion that will be paid to him or her, the statement says.

The proposed changes will ensure that, regardless of when a retirement fund benefit becomes payable on or after March 1 this year, if a portion has been awarded to the divorced spouse of a member in terms of a divorce order, the non-member former spouse will pay any tax due on his or her portion in the tax year that the benefit becomes payable.

The fund will get a tax directive from the South African Revenue Service (SARS) and deduct the tax before paying you out.

The exception will be in cases where the divorce order was issued before September 13, 2007. It will be proposed that any amount that becomes payable by any retirement fund on or after March 1 to a former spouse in terms of a divorce order issued before September 13, 2007 will be tax-free.

Currently, in the case of divorce orders granted before September 13, 2007, if a non-member spouse claims payment from a private sector retirement fund on or after March 1, 2009, but before the member leaves the fund, neither party will pay tax on that amount.

The clean-break principle for private sector retirement fund benefits on divorce was introduced by way of an amendment to the Pension Funds Act that took effect on November 1, 2008.

Before the principle was introduced, divorcees had to wait until their former spouses resigned or retired from their funds to get access to their portion of the pension interest awarded to them in terms of a divorce order.

The portion awarded to a non-member spouse remained in the fund for what was often many years, and the non-member spouse did not enjoy any growth in the portion awarded to him or her.

The clean-break principle allows the non-member spouse to transfer his or her portion of the pension interest to another retirement fund and to benefit from the growth on the money.

However, if the money is not transferred to another fund and is withdrawn as cash, tax becomes payable on all but R22 500 of the amount withdrawn.

Withdrawals of retirement fund benefits before retirement count against you because they reduce the tax-free lump sum you are entitled to when you retire.

Currently, to the extent that a member is taxed on a pension interest paid to a non-member former spouse, he or she will be negatively affected when the lump-sum tax tables are applied at retirement.

Treasury's media release notes that former spouses of members of the Government Employees Pension Fund (GEPF) will soon be able to get access to their share of a pension interest in the GEPF awarded to them in terms of a divorce order.

Last year, the law governing the GEPF was amended to include the clean-break principle. However, the rules of the fund still need to be changed and it is expected that this will happen before the end of this month.

A former spouse of a member of the fund had challenged the fund in court over its failure to introduce the clean-break principle, saying it was unconstitutional for divorced spouses of members of private sector funds to get access to their share of a pension interest while the divorced spouses of members of the GEPF could not.

Treasury says the tax law amendment that will take effect from March 1 will accommodate the introduction of the clean-break principle by other public sector funds, ensuring that when members of these funds split pensions on divorce, the taxation of the benefits will be on an equal footing with that for private sector fund members.

SARS will now issue directives through the tax directive system in line with these changes, treasury says.

TAXATION OF DIVORCE ORDER-RELATED RETIREMENT BENEFITS			
SCENARIO	**CURRENT DISPENSATION**		**RESULTS OF PROPOSED AMENDMENTS**
	Election in time on or after March 1, 2009	No election on or after March 1, 2009 or no clean break	Election or no election, and whether the fund has incorporated clean break or not
Divorce before September 13, 2007	No tax	Member taxed	No tax
Divorce on/after September 13, 2007	Non-member taxed	Member taxed	Non-member taxed