

LEVERAGE

Note from the editor

Sharon Teubes, Senior Legal Adviser: Advice and Wealth Management

So Europe bailed out the Greeks, again. If we are honest, there is no way that the Greeks will be able to pay off the debt and therefore this will continue to be a rocky situation well into the future. At least the SA market showed its resilience during this temporary hiccup and did not react to the negativity in any major way.

For SA it has been an interesting couple of weeks with the press allowed to visit Nkandla to see what the money was spent on – or should I say – what the money was not spent on. More questions have been raised than answered and the ‘fire pool’ with its child’s safety-net over was eventually conceded to be a swimming pool. Really, is this what our politicians and government is keeping themselves busy with? SA has serious financial requirements like our electricity infrastructure, waterworks, education and let us not forget security. Yet our government thinks it prudent to do home improvements in the most dilapidated way, so you have to ask, where is the money?

In addition, the world has been up in arms over the death of Cecil the lion. Do not get me wrong – I am an activist for the humane treatment of animals and conservation of all animals and I do not condone his death. Why this is such a hot topic is debatable. However, it is alarming that the senseless murder of farmers and police officers, the killing of people by ISIL

and Boko Haram, the death of hundreds of migrants every month trying to flee North Africa, and the death of children abusing drugs among other things is not. The answer to the question of this global reaction is still unclear, but it is important that the question is asked. Does the answer perhaps lie in the fact that the other crimes against humanity are just too harsh to deal with as it will require us to acknowledge that we do not know how to solve it?

One true lesson I have learnt is that if you want change in the world it starts with you. Let us not bemoan the change we would like to see, let us rather be the change – one small step at a time and one day at a time.

In this month’s edition, Paul Nell will revisit the impact divorce has on a person’s retirement funds. We are often faced with questions regarding this topic and very often have to return divorce orders that cannot be actioned due to incorrect wording. I am sure his article will answer some of those recurring questions.

Tanya Cohen will also focus on divorce and looks at how it will impact a person’s will and trust.

Happy reading!

Divorce and retirement funds

By Paul Nell, Legal Adviser: Financial Planning Advice and Wealth Management

Introduction

You could argue that in recent years there is an additional certainty in life aligned to the existing two, namely: taxes (more taxes), death, and it seems, divorce. The Department of Justice and Constitutional Development's Annual Report 2012/2013 confirms that SA is the infamous front runner with regard to matrimonial woes and mistakes as the figures ratify that the divorce rate increased by 28% from 39 573 to 50 517 cases.

In addition, the Sunday Times, reported that, "Divorce lawyers and marriage councillors say, however, that sex and money is behind the spike. They say that adultery, unrealistic expectations and a lack of sexual intimacy play a huge part in this". In addition, the median age at divorce in 2012 for men was 42 years and 38 years for women.

In the financial planning world it is almost unavoidable that you will at some stage deal with a client's divorce. It is absolutely crucial that financial planners engage with their clients and their attorneys, especially when the parties address the division of retirement funds.

Prior to 1989 amendment

The Divorce Act was amended in 1989 to allow for the division of the 'pension interest' of a member upon divorce (excluding those married out of community of property without the accrual).

Prior to the amendment, the non-member spouse had to wait until the pension benefit accrued to the member (usually at retirement, death or resignation). Also, it was

common practice for some members to delay retirement in respect of the retirement annuity fund for as long as possible – just to get in the last stab, and thereby delaying the obligation to pay for as long as possible. A further concern was that the non-member spouse did not enjoy any growth on the awarded portion from the date of divorce until the eventual payment date.

Based on this amendment, the impact of the marital system on the division the pension interest upon divorce can be illustrated as follows.

Marital regime	Non-member spouse entitled to a portion of the member's pension interest
In community of property	Yes
Out of community of property with accrual	Yes
Out of community of property without accrual	No

The 'Clean Break' principle

Enter the 'Clean Break' principle, which was introduced in the Pension Funds Act through the amendment of Section 37D(1)(d) (effective 13 September 2007). This change allowed a retirement fund to deduct from the member's benefit or minimum individual reserve any amount assigned to a non-member spouse in terms of a decree of divorce order granted under the Divorce Act.

A further amendment was made in 2008 to make the 'clean break' applicable to all divorce orders granted after 1989.

The impact of this amendment is that the amount allocated to the non-member spouse in respect of the member spouse's pension interest, has to be paid to that non-member spouse at the time of the divorce. Thus, the non-member spouse no longer has to wait until the benefit accrues to the member spouse. The fund can then either pay the amount to the non-member spouse or the non-member spouse can elect to transfer it to another approved retirement fund. Thereby, non-member spouses can enjoy growth on the funds until their retirement date.



What is the meaning of 'pension interest'?

A thorough understanding of what constitutes 'pension interest' is imperative when you engage with a client that is in the process of getting divorced. You need to distinguish the difference of the definition of a pension interest as it applies to a pension fund (herein including a pension fund, provident fund, pension preservation fund and provident preservation fund) and a retirement annuity fund.

'Pension interest' is defined in the Divorce Act and it reads as follows:

1. in respect of a member of a pension fund (includes provident funds and preservation funds) – the benefits to which the member would have been entitled in terms of the rules of the fund if their membership of the fund would have been terminated on the date of the divorce on account of their resignation from their office; and
2. in respect of a member of a retirement annuity fund – the total amount of the member's contributions to the fund up to the date of divorce, together with a total amount of annual simple interest on those contributions up to that date, calculated at the same rate as the rate prescribed...

The interest rate prescribed is currently 9% per annum (changed from 15.5% with effect from 1 August 2014).

Let us look at why this is so contentious in practice.

Example 1

- Member: Tarzan
- Pension fund value on date of divorce: R2 000 000
- Jungle retirement annuity fund value on date of divorce: R2 000 000
- Jungle retirement annuity contributions up to date of divorce plus 9% interest per annum: R1 200 000.
- Non-member spouse: Jane
- Divorce order: Jane entitled to 50% of the pension interest of each fund

What amounts will constitute the 'pension interest' that Jane would be entitled to?

- Pension fund: 50% of the pension interest = R1 000 000 (50% of R2 000 000)
- Jungle retirement annuity fund: 50% of the pension interest = R600 000 (50% of R1 200 000)

As illustrated, the difference in the definition of pension interest regarding the retirement annuity can be substantial – the problem is, Jane would generally base her expectation on the fund value of R2 000 000. It is imperative that the member and non-member spouse are aware of the meaning of 'pension interest' and the applicability of it with regard to the appropriate retirement vehicle.

Wording of the divorce order must bind the retirement fund

Without a doubt, an area that causes conflict between the parties and the trustees of the retirement fund is the wording of the divorce order. In order for the retirement fund to give effect to the divorce order it must fulfil three requirements.

Division of pension interest

The divorce order must be clear with regard to what percentage of the pension interest or what amount is due or assigned to the non-member spouse. For example, the requirement will be satisfied where the wording states that "the non-member spouse is entitled to 50% of the member's pension interest".

Identification of the retirement fund

It is crucial that the fund is named and is identifiable from the divorce order. Most divorce orders will name the retirement fund and also provide the appropriate policy or membership number.

Fund must be ordered to pay

Of the said requirement it is this one that is most problematic as the divorce order must specifically order the retirement fund to pay the amount to the non-member spouse.

Suggested wording:

1. The defendant is a member of the ABC Provident Fund ('the fund').
2. The plaintiff is entitled to 50% of the defendant's pension interest in the fund as defined in Section 1 of the Divorce Act*.
1. The fund is ordered to pay or transfer the assigned portion of the pension interest to the plaintiff or an approved fund on her behalf in terms of Section 37D(4) of the Pension Fund Act.

**In the case of a preservation fund the reference should be to Section 1 of the Divorce Act, read together with Section 37D(6) of the Pension Funds Act.*

Where the divorce order is not binding on the retirement fund, the defective order will need to be amended. This will result in the parties having to make application to the relevant court and further costs will be incurred. A new divorce order will need to be issued by the relevant presiding judicial officer.

Who pays the tax and when?

Where the non-member spouse takes a cash lump sum from the fund, the income tax rules are as follows.

Date of divorce order	Tax liability
Granted before 13 September 2007	<ul style="list-style-type: none">If accrual before 1 March 2009 then the member is liable (highest average tax rate) – can claim it back from non-member;If accrual is after 1 March 2009 then tax-free.
Granted from 13 September 2007 to 28 February 2009	<ul style="list-style-type: none">If accrual before 1 March 2009 then the member is liable (highest average tax rate) – can claim it back from the non-member;If accrual is after 1 March 2009 then the non-member spouse is liable (withdrawal tax table will apply).
Granted after 1 March 2009	<ul style="list-style-type: none">Non-member spouse (withdrawal tax table will apply).

Note

'Accrual' refers to the date that the non-member spouse elects to have the monies paid directly to them (subject to potential tax liability as above) or transferred on their behalf to another approved retirement fund (which will be tax-free where the full amount is transferred).

Financial planning impact: Non-member spouse elects to take monies in cash versus transferring to an appropriate retirement vehicle

Scenario 1:

Withdrawal of awarded pension interest

- Client: Suzie
- Divorced: 1 June 2014
- Retirement vehicle: Retirement annuity
- Amount received upon divorce: R500 000
- Tax payable: R85 500 (withdrawal tax table)

Suzie now retires from her retirement annuity a couple of years later and elects to take a third (R1 million) in cash.

- Lump sum amount (a third): R1 million
- Previous withdrawal since 1 March 2009: R500 000
- Tax now payable: R292 500
- Thus, total tax payable: R378 000 (R85 500 + R292 500)

Scenario 2:

Transfer to another approved retirement fund

Upon divorce, Suzie transferred the R500 000 into her existing retirement annuity and then upon retirement took a third (R1 500 000) in cash.

- Lump sum amount (a third): R1 500 000
- Previous withdrawal since 1 March 2009: Nil
- Tax now payable: R292 500

Comment

The impact of aggregation as a result of taking the lump sum amount (R500 000) upon divorce (withdrawal), and taking the third lump sum amount (R1 million) at retirement has a negative financial impact of R85 500 upon Suzie from a tax point of view.

Conclusion

From a financial planning perspective it is imperative that the financial planner is included in the negotiations between the respective parties at the divorce negotiation stage. In addition, the financial planner must ensure the implication pertaining to 'pension interest' with regard to the retirement vehicles under discussion are understood by the parties as well as their respective attorneys.

Sources

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Fiduciary Corner

By Tanya Cohen, Fiduciary Specialist, Advice and Wealth Management

The effect of divorce on the will and family trust

Clients who are married often nominate each other as a beneficiary in their wills. Your clients must be consulted regarding their intentions subsequent to the divorce and make the appropriate changes to their wills. If the clients change their wills to disinherit the respective ex-spouse the answer is clear – the ex-spouse will not inherit.

If the clients do not change their wills, Section 2B of the Wills Act will apply. It provides that if a testator dies within three months of the date of divorce, any will executed prior to the divorce will be implemented as if the ex-spouse died before the date of divorce and will therefore not inherit. This is the position unless it appears from the will that the client intended to benefit the ex-spouse despite the divorce. If the testator dies more than three months after the date of divorce without having changed or revoked the will, then the ex-spouse will inherit.

You also need to consult with your clients in relation to the family trust. Married couples are often both nominated as trustees and beneficiaries of the family trust. This may need to change depending on the terms on which the couple divide their assets. If one spouse is to be removed, then that spouse will need to sign a resolution and depending on the terms of the trust deed, another trustee may have to be appointed. If your client wants to remove the ex-spouse as a beneficiary and some of the beneficiaries have 'accepted the benefits' of the trust, in the legal sense, then those beneficiaries would need to agree and sign the deed of amendment removing the ex-spouse as a beneficiary. There may also be tax implications if the trust is a bewind trust or if any assets have been vested in the ex-spouse but not distributed to yet. Always consult a specialist when amending a trust deed.

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