LRA GUIDES

TAXATION OF SUPERANNUATION FUNDS

[Operations Support Division]

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1.0 Abbreviations and Acronyms

The following abbreviations, acronyms shall, unless otherwise stated or required by necessary implication mean:

"**the Act**"	Income Tax Act 1993 (as amended);
"**Commissioner**"	Commissioner General of Lesotho Revenue Authority;
"**Complying superannuation fund**":	an employer or a self-provided superannuation fund that satisfies the conditions prescribed in the Regulations;
"**Dependant**"	in relation to the member of the superannuation fund means the spouse of the member or any child of the member who is under the age of 18 years;
"**Employer superannuation fund**"	a resident superannuation fund established and maintained by an employer, which satisfies the conditions prescribed by the Regulations;
"**Fund administrator/manager**"	a person who manages, operates and administers the superannuation fund for

	the benefit of the members or dependents;
"**Fund credit**"	the amount of benefit in a superannuation fund that is vested in a member, which a member is entitled to receive on withdrawal or exit from the fund;
"**LRA**"	Lesotho Revenue Authority as established in terms of the Lesotho Revenue Authority Act 2001;
"**Member**"	an employee participating in the superannuation fund, who is in the employ of the participating employer or any individual who qualifies for the benefits under the superannuation fund;
"**Non-complying superannuation fund**"	a Superannuation fund that has not been approved as a complying superannuation fund by the Commissioner;
"**Participating employer**"	refers to an employer who has established the superannuation fund for the benefit of employees;

"**Regulations**"	Income Tax (Superannuation and Life Assurance) Regulations, 1994 (as amended);
"**Resident superannuation fund**"	the superannuation fund that is organised, managed and controlled in Lesotho, and operated mainly for providing superannuation benefits to resident individuals;
"**Self-provided superannuation fund**"	a resident superannuation fund which satisfies the conditions prescribed by the Regulations;
"**Superannuation fund**"	a Pension, Provident, Benefit, or Retirement Annuity Fund and Group Life Assurance;
"**Year of assessment**"	means twelve months period ending on 31 March.

2.0 Background

Lesotho income tax law encourages long term savings plans by providing a number of tax benefits to employers and employees who make savings into superannuation funds. The main purpose of long term savings is to encourage employees to safe monies while they are still in the workforce. These savings are intended to be used at such time when the employees are unable to provide for themselves and their dependents because of various reasons including retirement, permanent incapacity or death. The tax benefits mentioned above are only enjoyable where the long term savings are made into complying superannuation funds.

However, it has come to the attention of the LRA that some fund managers and employers opt to engage into other dealings involving these funds which otherwise undermine the above stated intended purpose. These include the following;

- Misuse of Superannuation Funds for Short Term Savings

Most employers consider utilizing the superannuation funds to save monies for contract gratuities to be earned by contract employees upon expiry of employment contracts. Since contract gratuity savings are short term in nature, an inclusion of contract employees in a superannuation fund runs contrary to long-term savings nature of superannuation fund.

- Securing Home Loans using Superannuation Funds Credits

It is common practice that most fund administrators have a clause, in their superannuation funds rules, which enables members to pledge their funds credits as securities for home loans with financiers including commercial banks. The security of member's rights condition, as discussed and as will be seen later in the guide, provides that the fund will not be regarded as a complying superannuation fund if it is able to pledge its assets as security for a loan by a financier to a third party such as the employer contributor, an associate of the employer or the member of the fund. The intention of this condition is to ensure that the member's rights to receive benefits are not revoked whatsoever due to debt claims against such member by any creditor.

- Retention of Members' Benefits by Employers

In the absence of superannuation fund governing legislation in Lesotho, most employers include a clause in their rules that enables them to retain members' benefits as compensation for losses or damages suffered as a result of negligence or misconduct by the member. The employers use discretion to determine the amount of benefits to retain. This is in contravention with the vesting condition (as discussed below) unless such retention or recovery has been awarded by a competent court of law.

3.0 Purpose

This guide discusses superannuation funds' rules and conditions as contained in the Act with an objective of demonstrating ideal features of a complying superannuation fund according to the law. It is intended to assist non-complying funds to immediately regularize their operations in order to be compliant. Specific reference will also be made to tax treatment of contributions into, and payments from superannuation funds and administrative requirements.

4.0 The Law and its application

It is in the spirit of the Law that the superannuation funds be created and operated for the main purpose of providing benefits to members, or dependants of the members, upon retirement or death of such members. To attain this objective, superannuation funds must comply fully with the seven conditions as discussed below together with other taxation requirements.

4.1 Superannuation Conditions

4.1.1 The Security of Member's Rights Condition

A superannuation fund observes this condition if the rights of the members and those of their dependants to receive benefits are set out in and fully secured by the fund rules.

To ensure that the benefits of members and their dependents are fully secured, the fund must not be able to pledge its assets as security for a loan by a financier to employer contributor, associates of employer or the member of the fund.

4.1.2 The Vesting Condition

A superannuation fund observes this condition if member financed benefits and benefits arising directly or indirectly from employer's contributions made on behalf of the member vest in the member or member's dependants on the day on which the benefits accrue to the member.

4.1.3 The Portability Condition

A superannuation fund observes this condition if, on withdrawal from the fund, all the benefits vested in the member (including benefits transferred to the current fund from another complying superannuation fund) can either be:

- retained in the current fund, or
- transferred directly to another complying superannuation fund.

4.1.4 The Minimum Funding Condition

A superannuation fund observes this condition if,

(i) in the case of Defined Benefit Fund, the assets of the fund are sufficient to meet the minimum requisite benefits[1] for all members, any other equally ranking liabilities and the costs of administering and operating the fund. In order to ensure this, the fund administrator must obtain the certificate of solvency from the actuary for a period not exceeding four years. The certificate must state the minimum rate of contribution by employer for the assets of the fund to be reasonably regarded as sufficient to cover all liabilities stated above if the fund was to be terminated during the period covered by certificate. The certificate must be renewed at least twelve months before its expiry; or

[1] the minimum benefit to be preserved for the member of a superannuation fund;

(ii) in any other case, the benefits vested in one member would not leave the fund with insufficient assets to pay the minimum requisite benefits to all other members of that fund, if the fund was to be terminated immediately after vesting.

4.1.5 The Investment Condition

A superannuation fund observes this condition if:

(i) At all times the cost of Lesotho assets[2] (investment in Lesotho) of the fund is at least 20% of the total cost of all assets of the fund. This requirement however does not apply to non-resident superannuation funds; and

(ii) At all times the cost of in-house assets[3] (loan to or investment in participating employer or employer's associate) of the fund does not exceed 10% of the total cost of all assets of the fund[4]; and

(iii) The fund does not lend monies to the member or dependant of the member.

It is worth noting that, the assets acquired in a non-arm's length transaction are valued at its fair market value at the date of acquisition.

4.1.6 The Reasonable Benefits Condition

A superannuation fund observes this condition if the benefits that the members or dependants of the members are entitled to receive are not excessive with regard to:

[2] This includes an interest in immovable property located in Lesotho, shares in a resident company, interest in a resident Trust and securities issued by a resident or a Lesotho branch of a non-resident

[3] an asset of a superannuation fund that is a loan to, or an investment in, the employer who contributes to the fund or an associate of such employer.

[4] In the case of a public sector fund, in-house assets do not include the investment in securities issued by the Lesotho government

- the remuneration paid to the member by the employer; and
- the period of service of the member; and
    - any other particular circumstance of the case.

4.1.7 The Reporting Condition

A superannuation fund observes this condition if on the last day of each reporting period[5] the fund administrator issues a detailed report[6] to the members about the performance of their funds.

4.2 Taxation of Superannuation Funds

4.2.1 Contributions into Superannuation Funds

Contributions made into a complying superannuation fund by both the employers and the employees are allowable deductions. The employees' contributions are deductible from their employment income before charging Pay As You Earn (PAYE). The employers' contributions made for the benefit of employees are tax deductible as expenses in the hands of such employers.

In the case of employer superannuation fund the total contributions (employee's and employer's contributions) made for the benefit of an employee are limited to 20% of employee's employment income. In determining this 20% limit, the employee's contributions are taken into account first.

[5] This means the Superannuation Fund accounting period of twelve months.
[6] Refer to Regulation 14 for the report requirements.

In the case of a self-provided superannuation fund the total contributions made by the member (who is a resident individual) into the fund are limited to 20% of such member's gross income. The 20% of the member's gross income is reduced by any amount contributed for the benefit of the member into the employer superannuation fund, if any. That is, since employment income forms part of gross income, it will be excluded from the gross income in determining the 20% limit if the member and or the employer are contributing into the employer superannuation fund for the benefit of the employee. If there is no employer superannuation fund operated for the benefit of the employee, employment income will form part of such gross income.

It is worth noting at this point that contributions made into a non-complying superannuation fund are not tax deductible.

4.2.2 Lump Sum Payments

A lump sum payment[7] from a complying superannuation fund made in favour of a member or dependent of the member where the member has died is taxable at standard rate and the tax so charged is a final tax. In an instance where the recipient has elected for the payment to be included in the gross income, such payment will be taxable at marginal rates.

A lump sum payment from a non-complying superannuation fund on the other hand is included in the gross income of the recipient and taxable at marginal rates.

[7] A lump sum payment from a complying superannuation fund is regarded as a terminal benefit therefore it is taxable as such under Section 32.

4.2.3 Roll-over and Purchase of Pension/Annuity

Any amount of lump sum payment from a complying superannuation fund which is rolled over into another complying superannuation fund or used to purchase annuity within 90 days of the date of the payment is exempt from income tax.

In the case of expatriate Taxpayer[8], roll over can be made into any superannuation fund and annuity may be purchased from any person. In any other case, in order for exemption to remain valid, roll over must be made into another complying superannuation fund and annuity must be purchased from a resident person.

4.2.4 Income of Superannuation Funds

Income of a resident complying superannuation fund is exempt from income tax. The exemption is however not extended to the following:

- Lesotho source income of a non-resident superannuation fund, whether or not approved for tax purposes in Lesotho; or
- income of the fund administrator/manager whether or not such income is generated from or earned as a consideration for administering and operating the superannuation funds.

It must be noted further that income of a non-complying superannuation fund is not exempt from income tax.

[8] resident individual, other than a citizen or permanent resident of Lesotho, who is employed or engaged under a technical services contract (where technical services contract means a contract under which accounting, auditing, economic, financial, legal, management, engineering, architectural, surveying, or other similar professional service is performed).

4.3 Administrative Requirements

4.3.1 Pay As You Earn (PAYE)

The fund administrator has an obligation to deduct/withhold tax from:

- lump sum payments referred to in 4.2.2 above; and
- periodic payments made by the superannuation funds to the beneficiary (recipient).

For proper administration of PAYE, the fund administrator must issue a signed Tax Certificate (Form P16) to the beneficiary. The certificate must be issued within 28 days after the end of the year of assessment. This therefore implies that the fund administrator must register with LRA for PAYE purposes.

4.3.2 Approval of Fund Rules for Tax Purposes

The following documents must be submitted to LRA in order for Commissioner to approve any superannuation fund for tax purposes:

- an application/covering letter; and
- rules of the fund (both general and special rules); and
- any amendment to the rules(all amendments must be approved); and

In the case of a non-resident superannuation fund, the fund administrator must issue a written statement to the Commissioner confirming that the administrator will:

- deduct or withhold tax at applicable rate on payments made to the member or member's dependant; and
- remit tax deducted or withheld to LRA.

4.3.3 Transfers and Terminations

For transfers and terminations of superannuation funds, the LRA will need the listed documents from the following parties:

A. Fund Administrator of Transferring or Terminating Fund:

- application for tax directives;
- fund credits for all the members;
- member's salary history from the first month the member started participating in the fund (including from the first month of participation in the previous fund where the member had rolled over into the current fund); and
- notice of termination of the fund by participating employer.

B. Fund Administrator of Receiving Fund

- Governing rules of the new superannuation fund

C. Participating Employer

- A written statement signed by the members of the transferring fund informing the Commissioner that such members have:
  - (i) agreed to transfer from the current fund;
  - (ii) nominated the new fund as the receiving fund in which they are going to participate; and
  - (iii) notification letter from either the employer or Board of Trustees, informing the Commissioner about the transfer or termination.

It is essential to note that the requirements from both the participating employer and the administrator of transferring or terminating fund must be submitted to LRA as a single package by the fund administrator. Tax directives on the other hand will be issued based on the compliance of the transferring and receiving funds or terminating fund.

5.0 Conclusion

The tax benefits provided for under superannuation funds are meant for complying funds. These benefits include tax deductibility of contributions made for the benefit of the member and 25% exemption under terminal benefits regime. A superannuation fund is considered to be complying if it observes the above mentioned conditions which must be clearly stipulated in the fund rules.

Disclaimer

This Guide provides the general interpretation of the law and considers broad principles in guiding the application of the Income Tax Act on taxation and administration of superannuation funds. The Guide has no binding legal force and does not affect a Taxpayer's right of objection and appeal to the Commissioner General, the Revenue Tribunal or the Courts of Law. This Guide shall not affect the Taxpayer's right to argue for a different interpretation, where necessary, in any appeal process, as stipulated in the revenue laws. Neither is this Guide binding on the Commissioner General, should circumstances arise for deviation as necessary or as the Commissioner General may deem otherwise in his discretion.