REPUBLIC OF SOUTH AFRICA

IN THE HIGH COURT OF SOUTH AFRICA,
GAUTENG LOCAL DIVISION, JOHANNESBURG

CASE NO: 14/26868

(1) REPORTABLE: NO
(2) OF INTEREST TO OTHER JUDGES: NO
(3) REVISED.

10/8/2016
DATE

SIGNATURE

In the matter between:

MONTANARI, EMILIO PIETRO VALFREDO Plaintiff

and

MONTANARI, CHARMAINE HELEN (previously "*Hinchliffe* **Defendant**

J U D G M E N T

Summary –Living Annuity – defined in General Notice 18 of Second Schedule read with s 1 of the Income Tax Act No 58 of 1962 – living annuity acquired by annuitant spouse retiring from a pension fund during the course of the marriage – living annuity does not form part of the estate of the annuitant spouse for the purposes of assessing accrual of the estate – non-annuitant spouse may have right to such portion of the annuitant's periodical income derived from the living annuity.

VICTOR J:

[1] The plaintiff Mr Montanari and the defendant Mrs Montanari are in the midst of divorce proceedings. They were married on 4 December 1999 out of community of property subject to the accrual system as defined in the Matrimonial Property Act No 88 of 1984. The primary issue for determination in this application is whether the living annuities acquired by the plaintiff when he retired from his pension fund during the marriage should form part of the accrual in his estate on divorce. The parties agreed to separate the issue of the living annuity to be determined by this court as a number of the issues in the divorce trial depend on the outcome of this point.

[2] The purpose of a marriage out of community of property with the accrual is that the asset growth accumulated during the marriage will be shared equally on divorce or death. The question whether an income producing asset such as a living annuity with a notional capital value and strictly controlled by statute is in particular non-commutable [1] must on divorce be considered to be an asset in the annuitant's estate and be available for re-distribution.

[3] The parties have agreed that a living annuity is not a pension interest as defined in the Divorce Act No 70 of 1979. The defendant contends that the living annuity forms part of the plaintiff's estate whilst

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[1] General Note 18 Second Schedule to the Income Tax Act No 58 of 1962

he contends the contrary.

Background facts

[4] The history of the plaintiff's acquisition of the living annuity is as follows. In July 2008 the plaintiff used a portion of his pension benefit which arose out of his employment to purchase a living annuity with the company Glacier under investment plan No 002419307. In November 2011 the plaintiff retired from his employment and used remainder of his pension benefit to purchase a further living annuity also with the company Glacier under investment number 003491172. The plaintiff uses the living annuity as a monthly source of income.

Statutory Framework of the Living Annuity

[5] A living annuity is defined as an investment product that provides an income upon the annuitant's retirement from a pension fund. The annuitant has little flexibility with what he can do with the living annuity which is rigorously regulated by the Income Tax Act No 58 of 1962 (Income Tax Act). The annuitant can for example choose an income from a range between 2.5% and 17% per annum, he can nominate a beneficiary of what remains of the living annuity on his death and in the absence of a nominee it devolves on the annuitant's estate. In the normal course 'where the term annuity is involved, the substance of the transaction will involve an investment of a capital sum by an investor to produce a return to the annuitant, calculated by reference to that capital sum to which is applied an agreed or defined

percentage interest rate' [2].

[6] The plaintiff led the testimony of Mr Hunter Thyne who is an attorney specialising in Pension Fund Law and has drafted the documents for the Investec Living Annuity. He has also contributed to a book published internationally called Buy Ins and Buy Outs dealing with annuity purchases to buy a pension fund organisation and buyout when a pension fund organisation buys out its obligation to pay an annuity. Mr Thyne testified that the Commissioner of SARS allows a pension fund to discharge its obligation to pay to the member an annuity by interposing an Insurer registered in terms of the Long Term Insurance Act No 52 of 1998. The retirement annuity fund is defined in the Income Tax Act as a *bona fide* fund established for providing living annuities on the retirement of a tax payer. In a retirement annuity fund a member becomes unconditionally entitled to a living annuity, meaning he has a right to the annuity and not to the capital. He testified that the living annuity has a notional capital value and the capital is owned by the Insurer and is reflected on the Insurer's balance sheet. Mr Thyne in support of his opinion that the capital is owned by the Insurer referred to s 29 (4) of the Income Tax Act which provides that the annuity must be placed in,

> 'a fund, to be known as the untaxed policyholder fund, in which shall be placed assets having a market value equal to the value of liabilities determined in relation
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> ...
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> (iii) any annuity contracts entered into by it in respect of which annuities are being paid;'

[2] ANZ Savings Bank Ltd v FCT 25 ATR 369, Hill J at 391

[7] Mr Thyne referred to the constraints placed on living annuities in terms of General Notice 18 the Second Schedule to the Income Tax Act. The individual annuitant never has a call on the capital but only a call on an income derived from the value of what he described as the Insurer's capital. That income currently is between 2.5% and 17.5% of the notional capital. He testified that living annuities carry on 'living' until the capital value of the annuity that the Insurer owns is completely depleted or reduced down to a certain amount which makes it commercially unviable to administer. He mentioned a capital sum of approximately R50 000 as gazetted from time to time. He also testified that a living annuity is not taken into account for estate duty purposes. He testified if he had to draw a balance sheet up for any person who is receiving a living annuity it would not be reflected as an asset but the income derived from the annuity would form part of the estate

[8] In this case the source of the living annuity was the plaintiff's retirement from the pension fund. The definition of a living annuity is the right of a former member of a pension fund to an annuity and the amount of the annuity is determined in accordance with a method or formula prescribed by the Minister by Notice in the Gazette.[3] The plaintiff is

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[3] S 1 of the Income Tax Act provides that a living annuity means a right of a member or former member of a pension fund, pension preservation fund, provident fund, provident preservation fund or retirement annuity fund, or his or her dependant or nominee, or any subsequent nominee, to an annuity purchased from a person or provided by that fund on or after the retirement date of that member or former member in respect of which-

(a) the value of the annuity is determined solely by reference to the value of assets which are specified in the annuity agreement and are held for purposes of providing the annuity;

(b) the amount of the annuity is determined in accordance with a method or formula prescribed by the Minister by notice in the Gazette;

prohibited from demanding back the capital amount invested as its source is the pension fund.

Plaintiff's case

[9] The plaintiff presented the evidence of three experts, Mr Thyne, Dr Elizabeth Veir and Ms Deidre Van Niekerk. The defendant tendered the evidence of Mr Brian Immelmann an actuary. The defendant objected to the evidence of the plaintiff's experts on the basis that all the evidence of the plaintiff's witnesses really amounted to legal opinion on an aspect which the court must decide and their evidence should be disregarded. It is trite law that an expert cannot advise or give legal opinion on how to interpret a statute and this court is mindful of that. I considered that the evidence tendered by the plaintiff as providing expert background information of what living annuities mean in the industry. I find the plaintiff's witnesses have the necessary expertise in the field of living annuities. I also find that the evidence of the defendant's witness Mr Immelmann as having the necessary expertise in the field of calculating the actuarial value of an income stream. I also apply the principle that the opinion of the experts should not be

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(c) the full remaining value of the assets contemplated in paragraph (a) may be paid as a lump sum when the value of those assets become at any time less than an amount prescribed by the Minister by notice in the Gazette;

(d) the amount of the annuity is not guaranteed by that person or fund;

(e) on the death of the member or former member, the value of the assets referred to in paragraph (a) may be paid to a nominee of the member or former member as an annuity or lump sum or as an annuity and a lump sum, or, in the absence of a nominee, to the deceased's estate as a lump sum; and

(f) further requirements regarding the annuity may be prescribed by the Minister by notice in the Gazette;

proffered on the ultimate issue to be decided in this case. [4]

Context of acquisition of the living annuity

[10] The characterisation of whether a living annuity on divorce forms part of the accrual in a matrimonial estate is novel. Although the parties have agreed the living annuity is not a pension benefit, it is apposite to consider the jurisprudence which has emerged when dealing with pension benefits on divorce. The Supreme Court of Appeal has pronounced that a pension interest terminates if prior to the date of divorce the party has moved the pension fund or has resigned from his employment in respect of which he had an interest in a pension fund. In this regard Maya JA in *Eskom Pension and Provident Fund v Krugel* 2011 (3) BPLR 309 (SCA) 314 [2011] ZASCA 96 at para 12 stated 'that once a pension benefit has accrued to the member spouse before the date of divorce, the provisions of s 7(7) and 7(8) of the Divorce Act are no longer applicable'.

[11] This principle was followed in the matter of *Saunders v Eskom Pension Fund and Provident Fund 2013 JOL 30305 (PFA)*. The adjudicator held that the spouse had already resigned from his employment on the date of divorce and on a proper interpretation of s 7(7) and 7(8) of the Divorce Act No 70 of 1979 (the Divorce Act) there was no pension interest which formed part of his assets which could be assigned to the complainant.

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[4] *Holtzhauzen v Roodt* 1997 (4) SA 766 (W) Satchwell J

[12] The overriding consideration is whether within the context of the statutory framework of living annuities and its strict regulation, the capital can be said to be vested in the plaintiff for purposes of calculating the accrual. In this matter during the course of the marriage the plaintiff retired from his pension fund and used the pension benefit to acquire the living annuities. I cannot simply apply the dicta in *Krugel* supra without considering the purpose and context of a living annuity and its acquisition. In interpreting the law relating to living annuities, the context of how the living annuity could be converted from a pension fund to a living annuity is relevant. The purpose as testified by Mr Thyne was to continue to make the capital inaccessible to the annuitant. Context is one of the aspects relevant to the emerging trend in statutory construction. Wallis JA in *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 (4) SA 593 (SCA) at para 18 stated that the 'inevitable point of departure is the language of the provision itself, read in context and having regard to the purpose of the provision and the background to the preparation and production of the document.'

[13] The prohibition against the annuitant accessing the capital is a relevant contextual feature. Mr Thyne stated the following about pension funds in general:

'the legislature wanted to ensure that a benefit in a fund is there to pay an income on retirement. The member cannot use that as security, if the member gets into financial difficulty an individual cannot attach that to execute against the

judgment debt. Why? If that were so, the risk to the government of having to provide an income to that individual would increase and theoretically that is why the tax system is designed in the way that it is. You get an exemption or a tax deduction for making a contribution to a pension fund or a retirement annuity fund. The fund itself is not taxed. The individual is taxed when they draw an income or get a benefit. If they are getting a benefit, that benefit is itself protected in terms of section 37(a)(1)'[5].

[14] General Notice 18 provides that the annuity purchased is compulsory, non-commutable, cannot be assigned, reduced, hypothecated or attached by creditors as contemplated by s 37A and 37B of the Pensions Funds Act. This is a highly relevant consideration.

[15] The second witness on behalf of the plaintiff was Dr Elizabeth Veir who is the co-owner of an asset management consulting company to large companies like the Edcon group and Sasol. She works predominantly with living annuities. Her evidence really dealt with the fact that that living annuity is not a pension interest as contained in the Divorce Act. This much was agreed by the parties prior to the commencement of argument. She also went on to describe what living annuities were and this description was helpful to the court. She also emphasised the plaintiff's limitations in relation to the living annuity and the fact that the money could never during the plaintiff's lifetime accrue to him as capital. He was only entitled to the monthly, quarterly or other periodical payments.

[5] S 37A and s37B of Pensions Funds Act of 1956 read with General Notice 18 may not be

[16] The third witness on behalf of the plaintiff was Ms Deidre Van Niekerk. She had also been involved in the insurance industry for some time. She was a legal and business consultant with Allegiance Consulting (Pty) Limited. She completed her law degree at the University of Johannesburg. She is a certified financial planner and holds an advanced diploma in financial planning from the University of the Free State in investments and estate planning. She has been specialising in estate and business planning for 21 years and has contributed to the development of industry software.

[17] Her evidence was really in accord with the two previous witnesses. She analysed the nature of living annuity and concluded that the capital amount of the annuity could never be enjoyed by the plaintiff, only the annuity as paid out. She also confirmed the annuity is owned by the Insurer on behalf of the member. She did however emphasise that the word ownership was in inverted commas and therefore concluded that the non-member spouse, who is the defendant in this case, would only be able to have access to the annuity or income as and when it accrues to the annuitant. Ms Van Niekerk also testified that the plaintiff's personal portfolio of life annuities could not be assigned for the accrual calculation, as they are owned by Sanlam and not by him.

Defendant's submissions

[18] The defendant submitted that s 1 of the Income Tax Act provides that if no nominee is named then the capital sum or the lump sum could revert to the deceased's estate as a lump sum. In balancing the non-access to the lump sum during the annuitant's lifetime but that his estate being able to benefit does raise some ambiguity at first glance. The annuitant's death may be decades after the divorce. The estate of the annuitant's nominee only has a *spe* because by the time of his death the living annuity may have been fully utilised and non- existent or the legislation may have changed. The annuity is not guaranteed.

[19] It is the defendant's case that the fact that the annuitant can nominate a beneficiary during his or her lifetime means that he is in control of the underlying investment and the full capital amount can become available to the heirs on the annuitant's death or to his estate.

[20] The defendant relied upon the fact that the plaintiff could control whether to draw down between 2.5% to 17.5% on an annual basis as a feature that determines the living annuity is part of his estate. A further indication relied upon by the defendant was that the plaintiff could elect to change the underlying investment on an annual basis if he so wishes by transferring his investment to another approved fund. He could also deplete the capital held in terms of the living annuity during his lifetime. However that must be read within the context of s 1 of the Income Tax Act definition where that capital amount must be so low that it is no

longer financially feasible to keep the annuity going. That threshold is governed by a notice which the Minister made from time to time by Gazette.

[21] The defendant relied on the judgment of the *Commissioner, South African Revenue Service v Higgo* 2007 (2) SA 189 (C) a judgment by a full court Foxcraft J, Davis J and Waglay J. This case was determined prior to the introduction of General Notice 18 which took effect on 1 September 2008. The issue for determination in *Higgo* was whether the cost of the 'management fee' for administering the annuity could be deducted because the annuity income constituted gross income. In the course of determining that issue, the tax payer argued that the capital had disappeared after the annuity was purchased. At the pre-trial it had been agreed that the capital was paid to Momentum on the respondent's behalf and counsel for the tax payer was constrained by those agreed set of facts. The full court was not called upon to determine the fate of the capital in determining an accrual in a matrimonial estate. In determining the applicable fiscal principle of what constituted deductibility from gross income, the full court found that because the tax payer was entitled to regulate within agreed limits how much of that fund was paid to him annually (albeit within strict statutory parameters of 2.5% to 17%); could nominate a beneficiary after death and could even decide that the capital reverts to his estate, meant that the capital had not disappeared. On that interpretation the full court found that from a fiscal perspective in assessing whether a

management fee could be deducted from gross income emanating from the annuity the annuitant retained the capital amount.

[22] The full court also had to consider the argument that the test of ownership was the 'disappearance of the capital test' and found that it was misleading. In this matter it was submitted on behalf of the plaintiff that the capital amount could not be touched by him and therefore, although the word disappearance was not used, the fact that the plaintiff could not touch the money meant that it was no longer his asset.

[23] The defendant submitted that the income from the annuity could be calculated in such a way as to form a capital sum. The defendant submitted that the only purpose why a living annuity may not be transferred, assigned, reduced, hypothecated or attached by creditors, in terms of General Notice 18 is to afford a protection of the funds and the rationale was to afford that protection for citizens not to become a burden on the state after retirement. It was really a form of socio economic legislation and had no bearing on whether the living annuities were part of the plaintiff's estate.

[24] Mr Immelmann, an actuary called on behalf of the defendant. He testified that he could provide a value on the pool of assets on two specific dates, being the date of the latest statement which was 23 April 2015. He testified that the valuation of the assets is really the market value of the assets as at any particular date. He applied actuarial

methodology to estimate the value as at that date. He also confirmed that on the assumption that the assets are not the assets of the plaintiff that they belong to an insurance company, it would still be possible to value the income stream of those assets as at 11 November 2015.

[25] He was not able to confirm in cross-examination whether the assets belonged to the plaintiff or not, as this was not his field of expertise. He also stated that the living annuity has a value on a particular date; alternatively there is a stream of income which is an asset and has a value at any given moment. He compared it to owning a bond which is really a right to receive a stream of future income and that the bond has a value.

[26] He took the income stream valuation into account and stated that the income stream is no more than the discounted value of that stream of income and in which case the best approximation of that stream of income is the market value of that income from an actuarial point of view.

[27] I also raised with the defendant's counsel how would the plaintiff obtain an order directing that the Insurer must release whatever the accrual is determined to be, because of the nature of the contract between the plaintiff and the insurance company and also having regard to the limitations placed on that capital amount by the legislation.

[28] It was submitted that the court did not have to take into account how the plaintiff would have to pay this money; he would have had to make some sort of plan to pay that accrual if it is so ordered. This to me could lead to a situation that if the court were to make an order declaring that the living annuity forms part of the plaintiff's assets he could hypothetically be placed under severe financial pressure to pay that amount and this would defeat the purpose of the statutory framework where pensioners should not become a burden on the state.

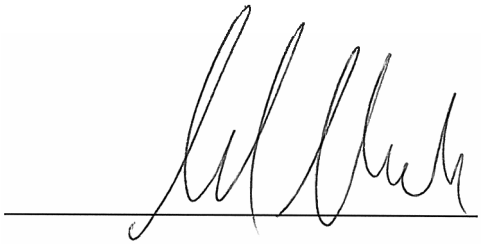
[29] If for example the defendant was entitled to R3 million of the living annuity, the plaintiff would have to borrow money and the interest payment on that would be substantial. The plaintiff in paying off the loan could well be left without any income at all. Having regard to the fact that the very purpose of the living annuity was to provide an income stream.

[30] The relevant context of the living annuity leads to the conclusion that the living annuity is not part of the plaintiff's estate for the purposes of accrual. The monthly or periodical payment of the annuity is relevant and can be taken into account to assess the future maintenance needs of the defendant.

The order that I would make is the following:

1. The living annuity does not form part of the plaintiff's estate.

2. The costs are costs in the cause of the divorce action.



M VICTOR

JUDGE OF THE HIGH COURT

GAUTENG LOCAL DIVISION

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