



DAVEY'S Locker



Davey's Locker

August 2010

Divorce awards & tax

The new amnesty

by Tony Davey

© 2010 A H Davey (tonyd@harding.co.za www.tonydavey.com)

The (oft invisible) hand of tax permeates most of our commercial and even domestic transactions. This tax reality was recently demonstrated in a divorce settlement agreement I reviewed from a tax and financial-regulatory perspective.

In the context of divorce settlements, the general tax principle is that the recipient-spouse's award (alimony or maintenance) is a tax-free receipt under s 10(1)(u) of the Income Tax Act. The payer-spouse, on the other hand, is denied the tax deduction of what constitutes domestic, as distinct from trade, expenditure.

Nevertheless, there are to my knowledge two exceptions to the general principle, which could adversely affect a recipient-spouse.

1. Retirement fund award

Under ss 7(7) and 7(8) of the Divorce Act a spouse of a member of a retirement fund may be awarded by a court a portion of the member's pension interest, (termed the 'minimum individual

reserve'). Section 37D(1)(d) of the Pension Funds Act authorizes a pension fund to deduct from the member's latent benefits and pay to the non-member spouse the amount so assigned by court order.

Paragraph (e) of the definition of the term 'gross income' in s 1 of the Income Tax Act includes, and thus to taxes, a lump-sum benefit from a retirement fund, while para 2(1)(b) of the Second Schedule to the act includes, as a lump-sum benefit, an amount assigned to the non-member spouse under a divorce award. This is taxed as a retirement fund lump-sum withdrawal benefit under the appropriate retirement fund tax table.

A retirement fund award derived on or after 1 March 2009 is taxed in the hands of the non-member-spouse, who thus bears the tax burden, as distinct from the member-spouse.

The non-member-spouse may, in lieu of immediately taking cash, transfer the award to a preservation fund, but, in doing so, merely defers the tax conse-

quences that will ensue upon subsequent withdrawal or retirement from the fund.

Deferred CGT

When an asset is transferred to a spouse under a divorce order para 67(2)(b) of the Eighth Schedule to the Income Tax Act relieves the transferor-spouse from CGT. The mechanism is called rollover-relief.

The sting in the tail for the recipient-spouse is that, upon a subsequent disposal, such as a sale, by that spouse, he or she will be subject to tax on the gain, being the realized proceeds, less the value of the asset as at the date of its *original acquisition* (not the date of the divorce) *by the ex-spouse*.

Mindful of these tax exceptions, you, too, should carefully evaluate any divorce settlement and, when applicable, recommend that a tax-compensatory adjustment be made as between the parties.

