

# CASE Study

## Ladies' man creates a tax conundrum

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**J**OE is a charming and well-known professor of physics at the National University in SA. Joe was popular with both his students and colleagues, particularly with his female colleagues.

In 1970, Joe married one of his colleagues, Dana, a professor at the same university. In 1985, Joe and Dana were blessed with a son, Joe Junior.

Although their marriage remained intact throughout the years, Dana was always concerned that Joe was too friendly with his female colleagues. In fact, on many occasions she found him in awkward situations with other female professors in his faculty, particularly with Jane, in the faculty tea room where they all met from time to time after lectures.

Dana complained to Joe, although she knew he was a ladies' man and unlikely to change.

In 2000, unhappy with the developments in their relationship, Dana asked Joe to move out of their marital home and, in her words "go stay with her". Appreciating the tension in their home, Joe decided to leave and joined Jane at her rented university flat. Relations between Joe and Jane went so well that they decided to move out of the flat and buy a home together in the northern suburbs of Johannesburg.

In 2004, Joe and Jane jointly applied for a home loan, which was granted. Since they earned an equal amount of income, they decided to share the financial responsibilities equally. This was Jane's idea — she was knowledgeable and cautious about financial management.

Joe also welcomed the idea because it would enable him to

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maintain his financial support for Junior, who was attending a university abroad. Under this arrangement, Joe supported Junior financially. In fact, there were times that Joe would request Jane to send money to Junior from her own source and he would pay Jane back whenever convenient.

For a period of at least 16 months, beginning in October 2005, Jane had paid Junior through this arrangement, although Joe never paid her back as in the past. Jane had never asked Joe to pay her back. This worked well for Junior because Jane would often give him more pocket money than Joe sent.

It became a general view to Junior that Jane was the one paying him for his upkeep because the money was always paid directly from Jane's bank account. During holidays Junior chose to stay with Joe and Jane rather than his mother Dana. Jane allowed Junior to use her car.

Since they were living together, Joe and Jane decided to nominate each other on their insurance policies and pension funds in late 2005. However, Joe nominated Junior to get 50% of his benefits in both his

insurance policies and pension funds. In the same year, Joe began to visit Dana regularly and admitted to Jane that they had been intimate again. This upset Jane, who decided to be intimate with Joe no longer, but agreed to continue to share other responsibilities and obligations with him. Jane removed Joe's name as nominee of her pension benefits.

In May 2007, Jane was invited to speak at the National Physics Presenters' Conference in Baghdad, Iraq. She agreed to speak on condition that the conference organisers arranged her return trip immediately after the conference. The organisers agreed to her terms.

After her presentation she was being driven to the airport when the car ignited a roadside bomb and exploded. All three delegates in the vehicle were killed.

Following Jane's death, a death benefit became payable by the National University Pension Fund, to be distributed in terms of the provisions of section 37C of the Pension Fund Act.

The board of management of the fund identified Joe and Junior as her dependants.

They approach you as a pension lawyer with two questions:

1. They want to know whether Joe qualifies as a dependant under section 1(b)(i) being a factual dependant of Jane or section 1(b)(ii) being a spouse of Jane;
2. They also want clarification on whether Junior could properly be classified as a dependant of Jane.
3. Consider the tax implications on the payments of any death benefits under these circumstances.

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## CASE Response

# Making the case for what should constitute factual dependency

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**I**N TERMS of section 37C of the Pension Funds Act, when allocating a benefit payable as a result of the death of a member, the board of a retirement fund has to consider the needs of that member's dependants.

If there are no dependants then the death benefit is payable to the person nominated by the deceased; and if there is no such nomination then the benefit is payable to the estate of the deceased.

The definition of "dependant" in the act distinguishes between those to whom the member was under a legal obligation to maintain, and those to whom the member was not. Those whom the deceased member is not under a legal obligation to maintain are categorised either as a factual dependant or a spouse or a child. A factual dependant is anyone who was at the time of death dependant on the member.

This excellent case study highlights when a person to whom the deceased member was not under a legal obligation to maintain, is a factual dependant.

In determining factual dependants, the facts applicable to each must be considered in the light of cases and legal thinking.

We begin with Joe. He is not a spouse in terms of the definition of "dependant". Nor was he entitled to maintenance from Jane's estate under the Maintenance of Surviving Spouses Act, as interpreted by the Constitutional Court in *Robertson & Another v Volks NO & Others (2004) 4 BPLR 5599 (CC)*.

Was Joe factually dependant on Jane? The facts indicate that they shared equally their financial responsibilities. The Pension Fund Adjudicator has held in *Van der Merwe v Central Retirement Annuity Fund* that this is insufficient to establish factual dependency which "requires, at the very least, a dominant or servient relationship in which one party is the substantive provider". As an extension the adjudicator determined that "mutual dependency does not suffice for the purposes of 'factual dependency'".



With respect, the adjudicator's reasoning should be questioned, particularly the relevance of whether the payments by a deceased member established a dominant or servient relationship. Perhaps the more correct test is whether a deceased member's payments, irrespective of any reciprocity, enabled the recipient to live at a standard of living which he or she would not otherwise have been able to enjoy.

In such a situation the deceased would have been aware of that standard of living and must, in the absence of anything to the contrary, be taken to have been agreed to it.

Whether or not the dependency may have been mutual is then not relevant. All that matters is whether the deceased member's payments enabled the recipient to live at a higher standard of living. If they were, then factual dependency is established to that extent.

Of course, the benefit from the deceased member need not be in cash: if it has a determinable financial value, such as the occupation rent free of a residence, then that is enough to establish factual dependency.

If the adjudicator's "dominant or servient" test were correct, payments by the deceased member to supplement income would preclude factual dependency. On the grounds proposed, factual dependency would exist.

In the latter instance was Joe factually dependant on Jane? The shared financial responsibilities enabled Joe to fund Junior's overseas university costs. The inference is that Junior and not Joe benefited from this arrangement.

For the past 16 months Jane assumed Joe's financial commitment to Junior. Is the fact that Jane did not require repayment relevant? No. Until Jane expressly waived her right to require repayment, or her right to claim repayment had prescribed, in law it was still owing by Joe to her. Jane's executor is entitled to claim that repayment.

It follows that Joe was not a dependant because his standard of living was not enhanced by the arrangement he enjoyed with Jane.

Turning to Junior, he was the true beneficiary of Joe's arrangement with Jane, and with Jane's knowledge and consent. In fact, she paid him more than Joe would have (more pocket money that is), and he must be understood to be her factual dependant.

If no other dependants of Jane are ascertained then, because there is at least one dependant, none of the death benefit is payable to Jane's estate.

As there was no current beneficiary nomination it follows that the entire death benefit should be payable to Junior. Junior must, as he has a driving licence, be 18; and he is now a major in terms of the recent change in the age of majority brought about by the Children's Act.

The full death benefit may be paid to Junior. If Junior was, however, still a minor then, as Joe has not demonstrated any financial imprudence, there is no reason why the death benefit should not be paid to Joe, as Junior's parent and guardian, rather than to a trust for the benefit of Junior.

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