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Understanding death benefits and section 37C of the Pension Funds Act



Janine Langenhoven
Senior Legal Counsel

One of the most important points for members of retirement funds to note is that these funds are subject to section 37C of the Pension Funds Act, 24 of 1956 (the Act).

In terms of this section, retirement fund death benefits do not form part of the member's estate. Instead, they fall under the control of the fund's trustees for distribution to dependants and nominees, as prescribed by section 37C. Accordingly, the member's will (or executor) has no authority over these benefits.

The board of trustees of the retirement fund must pay the benefit to dependants and/or nominated beneficiaries (nominees), within 12 months of the member's death, in such proportions as the board deems equitable.

If the trustees do not become aware of any dependant and if the member has not designated a nominee, the benefit will be paid to the member's estate after the expiry of the 12-month period.

The trustees therefore have discretionary powers when awarding death benefits, and their overriding consideration should always be dependency and the equitable distribution of the benefit following their investigation.

What are the duties of the trustees in terms of section 37C?

Section 37C imposes three core duties on the fund's board of trustees:

- Identify and trace all dependants of the deceased and any nominees.
- Allocate the death benefit equitably among the dependants and nominees, taking all relevant factors into account.
- Determine the appropriate mode of payment for each beneficiary.

Beneficiary nominations

Members are encouraged to nominate beneficiaries on retirement fund contracts. However, they should be made aware that beneficiary nominations are only one of the factors that the trustees of the retirement fund will take into account when determining a fair allocation to dependants and/or nominees of the deceased member. Nominating a person as a beneficiary on a retirement fund does not guarantee that they will receive the benefit. Section 37C specifically requires that the trustees must ensure that persons who were dependent on the deceased member are not left destitute.

Who can be nominated as beneficiaries?

The member may nominate beneficiaries by completing the relevant section in the Ninety One Retirement Annuity Fund/Preservation Fund application form. Beneficiaries must be natural persons. However, the member (or a beneficiary who is awarded the benefit) may request that the payment be made to a trust – either an inter vivos or testamentary trust – where the member’s dependant(s) and/or nominee(s) are the beneficiaries of that trust. This option is discussed in more detail below.

The member may also amend the beneficiary nomination at a later stage by completing and submitting the required form.

Where no beneficiary has been nominated by the member, and no dependant has been identified, the benefit must be paid to the deceased member’s estate (less tax determined in accordance with the retirement tax table).

Who will qualify as a member’s “dependants”?

The Act refers to various categories of dependants:

Legal dependants – persons whom the deceased member had a legal duty to support at the time of death, namely spouses and minor children.

Factual dependants – persons who were not legal dependants but were in fact dependent on the member for financial support at the time of the member’s death (for example, paying someone’s rent or monthly expenses). The support must have been regular and in similar amounts; ad hoc or occasional gifts do not qualify as “factual” support.

Future dependants – persons whom the member would have become legally liable to maintain in the future, had the member not died. Examples include a fiancé, elderly parents and siblings who are not yet dependent but would likely become reliant on the member in the near future, or a child conceived but not yet born at the time of the member’s death.

Adult children of the member who were not factually dependent (that is, self-supporting majors).

Important: the mere fact that a person qualifies as a dependant in any of these categories does not entitle them to a benefit; it only entitles them to be considered by the trustees when allocating the benefit.

What factors will the trustees consider when awarding the benefit?

In deciding on an equitable distribution, the trustees must weigh a range of factors. The main factors include:

Extent of dependency

How much was each dependant financially dependent on the deceased member? Was the person fully dependent (for example, a non-earning spouse or a minor child wholly supported by the deceased) or partially dependent (for example, an adult child to whom the deceased contributed some money occasionally)?

Age of the beneficiaries

Younger children may require support for a longer period (school, university and so on), whereas an elderly dependant may also have significant needs (for example, medical care) but for a potentially shorter remaining lifespan. A beneficiary's age can also relate to their earning potential – for example, a 22-year-old child might have many working years ahead to support themselves, while a 75-year-old widow may not be able to restore her income.

Relationship to the deceased member

Spouses, life partners, and minor children usually have the strongest claims. More distant relatives (siblings, cousins) or unrelated nominees might be given less weight unless they can show strong dependency or other equitable grounds for inclusion.

Financial status and future needs

The trustees will consider each beneficiary's current financial position, their future earning potential and foreseeable future expenses or needs.

Wishes of the deceased (nomination)

While not binding, the member's wishes as expressed in the nomination form will be given serious consideration.

In addition to the above, other factors such as the size of the benefit available for distribution will be considered.

After weighing all factors, the trustees will decide on the split of the benefit. They will aim to finalise their decision (the allocation resolution) within 12 months of the member's death.

Are the trustees required to wait 12 months before distributing the benefit?

Section 37C gives the trustees up to 12 months from the date of death to identify and locate dependants, as well as locate nominees. This does not mean the trustees must wait a full 12 months if the investigation is completed sooner. Once they are satisfied that all dependants and nominees have been identified and sufficient information has been gathered, they may proceed to allocate the benefit.

Exception: if no dependants are identified, the trustees are required to wait the full 12 months before paying out to nominees or, if there are no nominees, to the estate. This is to allow any unknown dependants the opportunity to come forward within that period.

What are appropriate methods of payment?

After deciding who will receive portions of the death benefit, the trustees must determine how each beneficiary's share will be paid. Section 37C allows the trustees to decide on the most appropriate mode of payment for each beneficiary's share, taking into account the beneficiary's best interests. The main options are:

- If the beneficiary is a **major**, payment as a lump sum directly to the beneficiary, or to purchase an annuity in the name of the beneficiary (if the beneficiary so elects)
- If the beneficiary is a **minor**, payment as a lump sum to the minor's legal guardian, or to purchase an annuity in the name of the beneficiary (if the guardian so elects)
- Payment to a **trust** for the beneficiary's benefit (in certain scenarios, explained below)
- Payment to a **beneficiary fund** (a specialised fund for managing benefits of minors or persons incapable of managing their own affairs)

The trustees' decision on the mode of payment will consider the beneficiary's ability to manage a large sum, their age and legal status (minor or major), and any specific needs or vulnerabilities.

When may the trustees elect to pay the benefit to a trust?

Under Section 37C, a “nominee” may only be a natural person, and not a legal entity such as a trust. However, once the trustees decide to allocate a portion of the benefit to a particular beneficiary, they may then decide to pay that portion into a trust for that person’s benefit (as a method of payment).

Common scenarios where a benefit may be paid to a trust as a method of payment include:

The member nominated a trust in the beneficiary form (for example, “to the ABC Trust for my wife”, or “50% to my Family Trust”) as a way to benefit certain dependants and/or nominees. In this case, the trustees must first identify the actual dependants and/or nominees behind that trust, as those individuals are regarded as the true beneficiaries.

An adult beneficiary or the guardian of a minor beneficiary **requests that the awarded share be paid into an existing trust/testamentary trust** of which they are a beneficiary, or the minor is a beneficiary.

Tip: if there are special circumstances that the member would like the trustees to consider when allocating the death benefit – for example, reasons why they would like the death benefit to be paid to a trust rather than directly to the beneficiaries – they may submit a letter of wishes to be kept on record. It is important to update this letter should the member’s circumstances change.

Options available to beneficiaries

Beneficiaries may choose to receive their share of the benefit as:

- a lump sum (subject to tax);
- a compulsory annuity in their own name (for example, a living annuity); or
- a combination of the two.

If the beneficiary (or guardian of the beneficiary) elects to receive the benefit as a lump sum, how will the lump sum be taxed?

If the beneficiary chooses to receive a lump sum, it will be taxed in the hands of the deceased member. The fund is required to obtain a tax directive from the South African Revenue Service (SARS) before making any lump-sum payment.

Once a tax directive is issued by SARS, it is final and may not be cancelled. It is therefore important to obtain advice from a financial advisor/tax practitioner before the beneficiary informs the retirement fund of their decision to receive their share of the benefit as a lump sum and/or annuity. It is also possible to apply for a simulation tax directive before submitting the actual instruction.

The retirement tax table will be applied in respect of the total lump sums payable to all beneficiaries. Previous benefits received by the deceased member will be taken into account. The deceased member's contributions to retirement funds that did not rank for a deduction previously under the Income Tax Act (ITA) – referred to as excess contributions – will qualify as a deduction before applying the retirement tax table. The tax payable will then be deducted from the lump sum, and the beneficiary will receive the benefit net of tax.

Retirement benefit tax table

Taxable income	Tax
RO – R550 000	0% of taxable income
R550 001 – R770 000	18% of taxable income above R550 000
R770 001 – R1155 000	R39 600 + 27% of taxable income above R770 000
R1155 001+	R143 550 + 36% of taxable income above R1155 000

Steps to calculate tax in respect of the lump sum:

1. Add the current lump sum to all previous lump sums* and apply the current retirement tax tables.
2. Add all previous lump sums* and apply the current retirement tax tables.
3. Answer in step 1 minus answer in step 2 = tax payable on current lump sum.

*Only the following lump sums must be taken into account:

- retirement lump sums received after 1 October 2007;
- withdrawals received after 1 March 2009; and
- severance benefits received after 1 March 2011.

If the beneficiary (or guardian of the beneficiary) elects to receive the benefit as an annuity, how will the annuity be taxed?

If the beneficiary chooses to transfer the benefit to a compulsory annuity in their own name, the transfer is tax neutral. The income payable from the annuity will be taxed in the hands of the new annuitant (the beneficiary) according to their marginal tax rate.

The deceased member's excess contributions (that is, their contributions that did not qualify for a deduction under section 11F of the ITA) will not be taken into account. The tax exemption for annuities set out in section 10C of the ITA is only available to the person who made those contributions.

It is important to note that the beneficiary cannot retain the benefit in a retirement annuity fund or preservation fund. Upon the death of a retirement fund member, the ITA only allows the benefit to be paid as a lump sum (subject to tax), or, alternatively, for it to be invested in a compulsory annuity. As mentioned earlier, the beneficiary may also choose a combination of the two (lump sum and compulsory annuity).

Estate duty

Retirement funds are exempt from estate duty in terms of section 3(2) of the Estate Duty Act, 45 of 1955, irrespective of whether a compulsory annuity or lump sum is selected by the beneficiary/dependant, or the benefit is paid to the estate of the deceased member.

The deceased member's excess contributions will, however, be included in their dutiable estate for estate duty purposes to the extent that the benefit is received as a lump sum. If the benefit is received solely as an annuity, the excess contributions will not be subject to estate duty.

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Contact information

36 Hans Strijdom Avenue
Foreshore, Cape Town 8001

Telephone: +27 (0)21 901 1000
Client service support: 0860 500 100
Email: clientservice@ninetyone.com

Please contact our Advisor Service Centre on telephone: 0860 444 487. Alternatively, please contact your Ninety One investment consultant.

www.ninetyone.com