Standing and Select Committees on Finance

Revenue Laws Amendment Bill, 2016

National Treasury **| 3 March** 2016

national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

Officials present from National Treasury

- Ismail Momoniat – Deputy-Director General, Tax and Financial Sector Policy
- Hennie Lambrechts – Director, Legislative drafting
- Alvinah Thela – Director, Retirement funds
- Chris Axelson – Director, Personal income taxes and savings

National Treasury objective with 2016 RLAB

- NT seeks a way forward to proceed with existing retirement reforms, and does NOT want to dwell on the past and on differences
  - Our focus is on what is best for members of retirement funds (TCF)
- Retirement savings of members must be safe and protected at all times
  - We must strive for a united message (communications)
  - Public attacks on each other's integrity will only confuse members and lead to perverse outcomes like resignations
    - Let us all be constructive in our criticism!
    - Any player screaming fire will cause panic even if there is no fire!
- NT is open to further engagements, but such engagements must lead to clear and timely outcomes and not used as a delaying-tactic
- There is much to reform in the retirement industry, and some are urgent
  - Many bad practices exist (e.g. high charges, poor governance, poor communication, conflicts of interests, etc.)

Brief history of 2013 and 2015 tax law processes

- Law on annuitisation and tax harmonisation initially passed in 2013
  - 2014 TLAA postponed by one year, and request by SCOF for NT to continue engaging within NEDLAC with COSATU
- 2015 TLAA only refines coverage and increases de minimis to R247 500
  - Annuitisation would still be law even if 2015 TLAA not signed into law!
- Treasury informed all when releasing draft TLAB and media statement on 22 July 2015 that they would engage within NEDLAC and directly with trade union federations on annuitisation and tax harmonisation
- When no agreement in NEDLAC by Oct, MoF tabled 2015 TLAB on 27 Oct with media release and SCOF informed by NT of failure to reach agreement in NEDLAC. Asked to then consider 27 Oct options
- Report of SCOF on TLAB (B29A) dated 25 Nov 2015 provides excellent summary of process, including further consultation processes and meetings between NT and those with concerns

Post-enactment events

- After President signed 2015 into law, COSATU expressed its strong opposition to 2015 TLAB, and launched a section 77 notice at NEDLAC of intention to strike unless 2015 TLAA scrapped
- NUMSA, AMCU and NUPSAW also followed with s77 notices
- FEDUSA, NACTU, ASISA and BUSA still in full support of 2013 reforms
- Strong public opposition ignited fears leading to resignations to cash out
- Govt convened meetings with Nedlac constituencies and bilaterals to strive for greater consensus
- Cabinet meeting of 17 Feb 2016 announced two year postponement of annuitisation for provident funds, but continuation of tax harmonisation
  - NT statement "Tax benefits continue, annuitisation postponed" dated 18 Feb 2016 provided more detail, including intention of RLAB
- Govt committed to release of social security reform paper

Stakeholder views on retirement reforms (not in response to RLAB, but as previously expressed)

- COSATU, Numsa, Amcu, Nupsaw still reject the TLAA strongly
  - No changes to retirement funds without comprehensive social security
  - Claim that (1) law was passed without adequate consultation in 2013 and 2015 (2) that law instils preservation ‘through the back door’ & (3) that panic will cause workers to resign *en masse*
  - Access to “deferred wages” denied – which seems to imply that retirement savings (provident funds in particular) should be accessible so that one can pay off bond, pay school fees/tuition fees/use as capital for business, etc.
  - Annuities poor value for lower income workers and worried about bequests
- FEDUSA & NACTU have publicly come out in support of the law
  - In their view it is in the interests of their workers
  - NACTU has indicated it prefers a higher *de minimis*
- ASISA supports the law
  - Tax deductions for most workers increase
  - Retirement system is simplified
  - Annuitisation protects workers & their families
  - Concerns that any change in implementation will cause administrative difficulties as industry is ready to implement as legislated

Misconceptions on retirement reforms

- *Parliament did not have hearings and was not aware of COSATU stance*
  - SCOF did have hearings in 2015, and in 2013 and 2014.
- *NEDLAC meetings did not take place and hence there was no agreement process*
  - How does one get NEDLAC agreement if one party is determined to have no agreement? How to deal with key players outside NEDLAC?
- Public misled by following FALSE rumours:
  - Govt is taking away/nationalising people's provident funds
  - Annuitisation is pre-retirement preservation through the back door, and will not benefit widows and beneficiaries
  - Government employees resigning because affected by retirement reforms even though there are no changes to GEPF
- Some media have also contributed to confusion by repeatedly stating that employees will no longer have access to funds upon resignation

What are the facts?

- Govt has no intention of taking over any retirement fund, and all funds still left in full control of their trustees with their own service providers
- GEPF and all other pension funds are not affected by new laws
- New law does not amend pre-retirement preservation - withdrawals on resignation not affected in any way (even though Govt discourages)
  - But we must engage on preservation in next two years!
- Contradictory views expressed make it difficult to find a way forward
  - Some argue no role for the state in directing how retirement funds to be accessed (even when they agree to a tax deduction for RETIREMENT savings)
  - Some argue for more radical economic policies, yet draw on UK Conservative Party policy of phasing out of annuitisation
  - Strong opposition to any preservation, yet agree that those who do not preserve and annuitise are vulnerable to opportunistic fin advisers

Can the entire 2015 TLAA be scrapped?

- Some of the s77 demands call for the scrapping of 2015 TLAA
- TLAA is passed every year, and gives effect to the tax announcements made in that year's Budget
- Scrapping or not passing the TLAA will mean a rejection of the revenue proposals in the Budget, and may lead to funding problems and allows tax abuses to continue
- The 2015 TLAA does not deal with the tax harmonisation and annuitisation, as this is given effect by the 2013 TLAA
  - 2015 TLAA merely closes loopholes in coverage, and increases the *de minimis* from R75 000 to R247 500
  - If no 2015 TLAA, the retirement laws will still go ahead on 1 March 2016 but *de minimis* will be R150 000
  - If the law on annuitisation is to be changed, it is the 2013 TLAA that will have to be amended

Proposals in RLAB: Postpone annuitisation

- The proposal by the Minister of Finances is to <u>postpone the requirement to purchase an annuity for provident fund members for two years</u> to allow for more consultation within NEDLAC
  - The Revenue Laws Amendment Bill containing this proposal was tabled in Parliament on 24 February 2016 (Budget day)
- The proposed legislation:
  - Postpones the requirement to purchase an annuity for provident fund members to 1 March 2018 <u>(clauses 1 of RLAB)</u>
  - Extends the vested rights provisions to 1 March 2018. E.g. any provident fund member who is over 55 on 1 March 2018 will not be required to annuitise on retirement <u>(clause 1)</u>
    - Clause 1 is long because the paragraphs need to change the dates within the text for the vested rights provisions and is repeated for each type of retirement fund
  - Corrects the allowable deduction for the deemed value of the fringe benefit for defined benefit employer contributions to be equal to the deemed value, as it was previously limited by the actual contribution <u>(clause 2)</u>
  - Postpones tax-free transfers from pension and pension preservation funds to provident and provident preservation funds (to avoid pension fund members from transferring and getting a lump sum tax free) <u>(clauses 3 and 5)</u>

Proposals in RLAB: Postpone annuitisation

- The proposed legislation - continued:
  - Removal of the requirement to table a report on annuitisation <u>(clause 3)</u>
  - Postponement of tax-free payouts from compulsory annuities (annuities bought from provident funds) if the contribution did not receive a deduction <u>(clause 4)</u>

- The proposed legislation <u>does not:</u>
  - Change the implementation date of the tax deductions (s11(k) and paragraph 12D of the Seventh Schedule)
  - The increase in the threshold at which an individual must purchase an annuity (the de-minimis). This value still increases from R75 000 to R247 500 on 1 March 2016.
  - These aspects of the retirement reforms go ahead as planned

- There was some confusion on the annuitisation threshold since the higher threshold appears in the RLAB.
- However, the RLAB does not postpone sections 3(1)(n), 3(1)(s) or 3(1)(zB) of the 2015 Taxation Laws Amendment Act which increased the threshold initially, so it will apply from 1 March 2016

Advantages and disadvantages of proposal

- Advantages
  - The new tax deductions for retirement fund members (including employee contributions to provident funds) would remain in place
    - No change to payrolls and payslips designs as planned for 1 March 2016
    - Members might see a slight increase in net pay
  - Allow greater time to discuss annuitisation, noting that the tax deduction is directly linked to the requirement to purchase an annuity
  - Proposals to address concerns around annuitisation can potentially be enacted before the requirement to purchase an annuity is in place

- Disadvantages
  - The constant changes create confusion for members and funds, especially for those who were planning to transfer funds.
  - Fund rules may have been changed again
  - If the tax deduction continues with no annuitisation for provident funds it will place the whole retirement framework at risk (pension funds and RA's will be undermined)

Risks with 2016 RLAB

- What if there is no agreement after two years?
  - Govt has stated that if no agreement on annuitisation, than the tax deduction for retirement contributions will fall away
  - Removing the tax deduction will be contentious in two years time and may face as much opposition as annuitisation
- How do we prevent perverse outcomes?
  - Transfers from pension to provident funds? Who would want to remain in pension funds or RA's if can get the tax deduction at a provident fund without annuitisation?
  - Creation of new provident funds instead of pension funds in order to bypass annuitisation
- Will retirement system be more or less harmonised after two years?
- How does government proceed with preservation?

Future urgent reforms are already in process

- Coming default regs (see NT press release22 July 2015) will take the first step in proposing steps to lower charges and improve mkt conduct in retirement industry
- Annuity reform is a key priority within default regs and will go a long way to address legitimate concerns around current annuity products
- Most members of pension funds exit their funds and left on their own to choose annuity products on offer without much advice, and end up choosing an inappropriate product that leaves them more vulnerable as they age
  - All retirement funds will be required to provide in-house annuities and/or negotiate better annuity options
  - All retirement funds to provide financial (and mandatory) advice before retirement
  - Problem of widows and beneficiaries can be dealt with through more appropriate products (e.g. living annuities)
- Government also intends to offer retail-bond linked annuities to open up mkt
- Other reforms:
  - Removal of the means test for old age grant, particularly for those who save
  - Coverage of vulnerable workers
- Release of comprehensive social security paper later this year

END

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Reminder of types of retirement funds

	Contributions	Growth in the fund	Withdrawals (pre-retirement)	Withdrawals (post-retirement)
Pension fund	Deduction up to 27.5% (of RFI) for both EE and ER contributions	Tax free	Resignation, disability, death	2/3rds annuity
Retirement annuity	Up to 15% (of non – RFI)	Tax free	Disability, death	2/3rds annuity
Provident fund	Deduction up to 20% (of RFI) for ER contributions only	Tax free	Resignation, disability, death	Lump sum

- RFI is retirement funding income
- Pre-retirement withdrawals are taxed more harshly compared to on retirement

The impact of the 2013 legislation on pension funds and RAs

- Pension funds:
  - No change to annuitisation requirement
  - *De minimis* increased from R75 000 to R247 500 (by 2015 TLAA)
  - Employer contributions are a fringe benefit
  - Can now receive a higher tax deduction of up to 27.5% of the greater of taxable income or remuneration (base is higher)
  - A new contribution limit of R350 000 to ensure equity
- Retirement annuity funds:
  - No change to annuitisation requirement
  - *De minimis* increased from R75 000 to R247 500 (by 2015 TLAA)
  - Increased tax deduction to 27.5% of the greater of taxable income or remuneration
- Tax treatment completely aligned between pension funds and RA's
  - Much simpler
  - Fairer after the introduction of the deductibility cap

The impact of the 2013 legislation on provident funds

- Provident funds:
  - Required to purchase an annuity with 2/3rds
    - BUT only for contributions made after 1 March 2016 and
    - Only if member is under the age of 55 on 1 March 2016
    - And final pension value is over R247 500 when they retire (2015 TLAA)
  - Employer contributions are a fringe benefit
  - Employee contributions will now be tax deductible
  - Can now receive a higher tax deduction of up to 27.5% of the greater of taxable income or remuneration (base is higher)
  - A new contribution limit of R350 000 to ensure equity
- Tax harmonisation legislated in 2013 TLAA not TLAA 2015
- SCOF incorporated in 2015 TLAA the following:
  - adjusted *de minimis* from R75 000 to R247 500
  - added 2 year review of impact
  - Requested massive communication campaign