national treasury
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Motivation to comply with sections 8(5) and 11(3) of the Money Bills Amendment Procedure and Related Matters Act, 2009 for amending the Taxation Laws Amendment Bill, 2015, as tabled by the Minister of Finance on 27 October

Introduction

The Taxation Laws Amendment Bill, 2015 (TLAB) was tabled in Parliament on 27 October 2015. On 4 November 2015 the Minister of Finance requested that the Standing Committee of Finance (SCoF) consider amendments to the Bill, specifically relating to retirement reform and long term insurance. Since the Bill had already been tabled in Parliament, any proposed amendments made or approved by SCoF must comply with the Money Bills Amendment Procedure and Related Matters Act, 2009, including sections 8 and 11 of the Act. The SCoF called for urgent public comment and held a public hearing on the proposed amendments on 10 November 2015. This consultation was over and above the longer consultation period for the Draft TLAB published on 22 July 2015, with the closing date for comments on 24 August 2015. A draft response document to the TLAB and other tax amendments were published by the National Treasury on 15 October 2015. This note provides the information to help inform the requirements in sections 8(5) and 11(3) of the Money Bills Amendment Procedure and Related Matters Act, 2009.

The proposed amendment

The proposed changes to the tabled version of the TLAB in relation to retirement reform are not new and reflect the proposals in the version of the TLAB that was published on 22 July 2015 (in this instance, no change to tax legislation approved in 2013), which are part of the approved 2015 Budget proposals. The TLAB that was tabled in Parliament on 27 October 2015 contained a further option to delay the requirement to purchase an annuity for provident fund members by up to two years. The Minister of Finance requested an urgent consultation on the revised retirement reform proposal, and elaborated on additional potential options in the accompanying media statement.

After consideration of the comments received and after discussions with interested parties, the Minister of Finance recommended that the SCoF amend the TLAB to revert back to the original version as published on 22 July 2015 (i.e. as approved in 2013 legislation), but with a higher threshold at which retirement fund members are required to purchase an annuity, up from R150 000 to R247 500.

Potential impact of the amendment

Section 11(3) requires that the amendment considers:

- The revenue raised (to be consistent with the fiscal framework)
- Equity, efficiency, certainty, ease of collection

- The composition of tax revenues
- Regional and international tax trends
- The impact on development, investment, employment and economic growth

Section 8(5) requires that the amendment considers the impact on the fiscal framework, including elements of revenue, expenditure and borrowing.

The only change is the increase in the threshold at which someone should purchase an annuity upon retirement and so will only have an effect on those retiring in a given year. It is unlikely that any provident fund member would be impacted over the next few years since the vested rights provisions of the legislation allow for any member of a provident fund who is over the age of 55 at the implementation date (1 March 2016) to be able to take their full retirement interest as a lump sum.

The impact of the change will be on pension fund members and retirement annuity fund members who retire with a retirement pot of between R150 000 and R247 500. Currently, an individual with a retirement pot between those values would be required to purchase an annuity with two-thirds of that amount and take one-third as a lump sum. Under the proposed amendment, these individuals would be able to take the full amount as a lump sum.

Tax revenue implications

The proposed amendments revert to the law as it applied at the time of the 2016 Budget, and hence has been factored into the budget estimates as at 27 Feb 2015. There is therefore no significant change to the fiscal framework that informed the 2015 Budget. Though not required to compare with the MTBPS, it should be noted that the retirement reforms will also not significantly impact on the revised MTBPS revenue estimates.

In terms of a more micro-assessment to estimate the tax revenue impact, one can consider a specific example of an individual who retires with exactly R247 500 and compare the expected tax liabilities in the current position and with the proposed amendment.

It is likely that the affected individuals would take the full amount as a lump sum rather than purchase an annuity with two-thirds of their retirement interest.

- In the current environment, an individual with R247 500 at retirement would be required to purchase an annuity with two-thirds of that amount (R165 000) and can take a lump sum with the remainder (R82 500).
    - The R165 000 could provide an annuity of around R915 per month, or R11 000 per year. This amount would be taxable as income. The current tax free threshold is R73 650. If the individual does not have other income of at least R62 650, there would be no tax revenue from the annuity income.
    - The lump sum of R82 500 would fall below the tax free lump sum threshold of R500 000. However, this would only apply if previous lump sums that had been taken did not exceed R417 500 (as it is a cumulative total).
    - The current tax revenue from this individual is thus not expected to be substantial
- The proposal would allow the individual to take the full R247 500 as a lump sum.
    - The lump sum is still below the R500 000 tax free lump sum threshold, but there may be additional tax revenues if the individual has withdrawn more than R252 000 previously. Counter to this, there may be a decrease in tax revenues if the individual

had other taxable income where the annuity income would have generated a tax liability.

Investigating tax certificate data from the South African Revenue Service shows that there were around 350 000 individuals who received a retirement lump sum in 2013/14. Of these, 91 000 individuals received a lump sum from a retirement fund where the value was between R50 000 and R82 500 (which corresponds to a total retirement interest of R150 000 and R247 500[1]). Around 55 percent of people who contribute to a retirement fund are members of a pension fund or retirement annuity fund. Using the same proportion, one could say that around 50 000 people would be impacted from the change each year. Given that in many cases there would be no tax change and that the number of people impacted is relatively small, the tax revenue implications are thus expected to be negligible.

Equity, efficiency, certainty and ease of collection

The amendment would make the tax system more equitable both vertically and horizontally.

The original amendments in the 2014 legislation improve vertical equity by capping the deductible contribution at R350 000, hence limiting the extent to which high-income individuals can benefit from the tax deduction. The amendments also improve horizontal equity as the same treatment of retirement assets would apply to all members of retirement funds, regardless of the type of fund and would not harm the efficiency of the tax system as it would not create additional distortions in behaviour (individuals cannot easily choose the level of their retirement assets at retirement). The amendment also allows members of provident funds who make their own contributions over and above that of the employer to benefit from the tax deduction if they are above the tax threshold.

The change would not create additional uncertainties and the administrative process is already in place and would be easy to implement. Implementing this reform will in fact bring more certainty to taxpayers.

Composition of tax revenues

Given that the revenue impact is expected to be negligible, there would be no impact on the composition of tax revenues, including between direct and indirect tax revenues.

Regional and international tax trends

There should not be any regional implications, and regional trends are not readily available, as retirement systems are not very developed in the region beyond South Africa.Internationally, tax trends also differ significantly between countries, not only depending on the level of development, but also between similar advanced or developing economies. Whilst the challenges in most developing economies is to deal with poverty, unemployment and inequality, the challenges in advanced economies differs on annuitisation, given that their residents are often part of a state-supported pension system with high coverage. Hence trends in advanced economies can be in total contrast with each other, so whilst Australia has recently announced that they are considering implementing compulsory

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[1] Although this could include individuals who took the full lump sum as the value was below the R75 000 threshold in place for the 2013/14 tax year. The figure is likely to be an overestimate.

annuitisation, the UK has removed the requirement to purchase compulsory annuities. In both these countries, the key factor to consider is how vulnerable workers are when they retire, and what broader support systems exist in that society or country.

Development, investment, employment and economic growth

The increase in the minimum threshold may result in fewer annuity purchases, decreasing the number of products sold by life companies. This may also result in a small decrease in investment, but only if the lump sum amounts are not invested by the individual. The impact on employment and economic growth is thus not expected to be significant.

The fiscal framework

As described above, it is expected that the amendment will have a negligible impact on tax revenues, as announced in the 2015 Budget.. The amendment will also not have an impact on government expenditure or borrowing within the revised fiscal framework as published in the 2015 Medium Term Expenditure Framework tabled on 21 October 2015.