Standing Committee on Finance (SCoF): Response document

17 November 2015

Draft Second Response Document from National Treasury to SCOF on amendment to the Taxation Laws Amendment Bill, 2015 in relation to retirement reform and long term insurance[1]

1. BACKGROUND

1.1. PROCESS

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 (Annexure A: Letter from the Minister to the Chairperson of SCOF). 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 draft Second Response Document provides the National Treasury's response to comments received for the second shorter consultation period.

1.2. LEGISLATION

The Taxation Laws Amendment Act, 2013 included provisions to harmonise the tax treatment of contributions to retirement funds by allowing for a tax deduction of up to the lesser of: 27.5 per cent of the greater of taxable income or remuneration; or R350 000. Along with the simplified tax deduction, provident fund members would be required to purchase an annuity on contributions made after the effective date of the proposals, but provident fund members over the age of 55 would be unaffected. The effective date of the reforms was 1 March 2015.

After consultations with NEDLAC and some of its constituency members in the latter part of 2014, and after consideration by the SCoF, the effective date of the retirement reforms was delayed to 1 March 2016. The was effected through the Taxation Laws Amendment Act, 2014 which amended the Taxation Laws Amendment Act, 2013 to revise the effective date to 1 March 2016, and which also included other amendments to the Income Tax Act to provide

[1] The first draft Response Document was published on 15 October 2015 and covered all the amendments in the Taxation Laws Amendment Bill, 2015. The content of this document will be merged with the content of the first draft Response Document and incorporated into a final Response Document.

further detail on aspects of the reforms relating to the valuation of defined benefit contributions (section 12D) and vested rights for provident fund members.

The draft Taxation Laws Amendment Bill, 2015 that was published on 22 July 2015 contained no new substantial changes to the tax harmonisation of retirement funds and annuitisation (except to close loopholes related to gaps in coverage and estate duty avoidance), although the accompanying media statement mentioned that there could be a possible change to the thresholds. However, to provide for further opportunity for discussion around the impact on provident fund members, the version of the Bill that was tabled in Parliament on 27 October 2015 included new provisions to enable a phased approach to the annuitisation of retirement funds legislation. In the phased approach provident fund members could get the full tax deduction in the 2016/17 tax year, but would not be required to purchase an annuity. In 2017/18 the tax deduction would be decreased to 10 per cent (with a R125 000 monetary cap) as there would still not be a requirement to purchase an annuity. In 2018/19 provident fund members would be required to purchase an annuity from future contributions, but the tax deduction could be aligned with other retirement funds at 27.5 per cent (with a R350 000 monetary cap).

1.3. POLICY ISSUES AND RESPONSES

The proposed changes to the tabled version of the TLAB can be divided into two sets of proposals; retirement reform and taxation of insurance companies.

Retirement reform proposals

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 Draft TLAB published on 22 July 2015 (in this instance, no change to tax legislation approved in 2013, as amended in 2014), which are part of the approved 2015 Budget proposals.

Following a period of consultations within NEDLAC and with key NEDLAC stakeholders, the TLAB that was tabled in Parliament by the Minister of Finance 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 National Treasury requested an urgent consultation on the revised retirement reform proposal, and elaborated on additional potential options in the accompanying media statement (Annexure A).

After a period of consultation and discussions with interested parties (Annexure B), the Minister of Finance requested in a letter to the Chairperson of SCOF (Annexure C) to effectively revert back to the 2013 legislation (as amended in 2014) and hence as published on 22 July 2015, but with a higher threshold at which retirement fund members are required to purchase an annuity, up from R150 000 to R247 500. This was to take into account concerns from some labour federations that lower-income workers were reluctant to annuitise on retirement. This Response Document covers comments received on the proposal to amend the tabled Bill.

1.4. PUBLIC COMMENTS

There were twelve written responses received (refer to Annexure D), mainly from industry associations, tax practitioners and retirement fund administrators, and one trade union federation, and from individuals in their personal capacity. Four representatives also presented their responses orally during the public hearings hosted by the SCoF on 10

November 2015. Eleven of the twelve submissions related to retirement reform, while one related to the taxation of insurance companies.

Eleven of the twelve written submissions related to retirement reform (and one to long term insurance). Of the eleven retirement reform submissions, eight favoured the proposal of proceeding with the 2013 legislation with a higher annuitisation threshold, while two felt that the reforms should be postponed until the paper on comprehensive social security is released and discussed and one felt that the reforms should be delayed to 1 March 2017 to allow more time for consultation.

Comments that provided suggestions of technical corrections to the legislation have not been included in this response document, but will be considered for further Annexure C technical amendments for legislation next year. These relate to the provisions for vested rights in the case of divorce and for the transfers of assets between retirement funds, amongst others.

2. RESPONSES TO COMMENTS RECEIVED

2.1. Proceeding with the retirement reform amendments in the 2013 Taxation Laws Amendment Act with a higher annuitisation threshold

[Section 1 - definition of 'pension fund', 'pension preservation fund', 'provident fund', 'provident preservation fund', 'retirement annuity fund' and section 11(k)]

Comment: Strongly in favour of the proposed option that is being put forward where the design closely matches the policy that was legislated in 2013 and 2014, but with a higher threshold at which an annuity is required to be purchased and strongly in favour of proceeding with the retirement reform amendments from 1 March 2016. A policy that carves out provident funds with a lower tax deduction threshold would not achieve the objectives of simplification, harmonisation and encouraging preservation. The current design will also encourage the consolidation of retirement funds and assist in bringing costs down for members. Many in the industry have already made signification progress in re-designing their IT systems to incorporate the changes. Any further delays will add to the costs already incurred by employers and industry (and most of which will ultimately be transferred to members of provident funds) and create further uncertainty, diminishing confidence in the retirement fund industry from members.

> *Response:* Noted. Agree that implementing the proposal will achieve certainty, increase simplicity and harmonisation and encourage preservation. More seriously, delaying implementation would still allow scope for abuse through structuring by higher-income tax payers, who would receive the tax deduction without being required to purchase an annuity on retirement.

Comment: There should be a moratorium on the implementation of the Taxation Laws Amendment Act, 2013 in relation to the preservation of provident fund member's benefits until there is agreement and implementation of a comprehensive social security and retirement reform policy. The discussion paper on Comprehensive Social Security should be released and engaged on at the same time as engagement on these reforms. Government cannot unilaterally change provident fund benefits for workers and the reforms should be postponed until agreement is reached in NEDLAC.

> *Response:* Not accepted. Agree that it has taken considerable time to finalise the discussion paper on comprehensive social security, mainly because it is a highly complex area, and involves several departments in government. Government remains committed

to releasing the paper as soon as possible, and after approval by Cabinet. However, the key insight from that process is that it would be difficult to achieve a major reform in one step, and should be seen as a series of incremental changes and steps toward the same objective. Following the publication of the paper, social security reform will still take a number of years to be implemented. Delaying the implementation of the retirement reform amendments will mean that current members of retirement funds will continue to be treated unfairly with regard to higher charges, denial of tax deductions for provident fund members, and poorly designed annuity policies. The only beneficiaries to any delay will be those currently benefitting at the expense of members, and will also allow a fragmented and complicated tax regime for retirement funds to continue. Further, the taxation system will continue to benefit those on higher incomes who receive favourable tax deductions, making the tax system less progressive. .

Comment: The R350 000 monetary cap for deductions to a retirement fund is against the principle of encouraging individuals to save further and is likely to impact on employees who already face higher progressive taxes and a higher overall tax burden. The monetary cap has also not been adjusted since 2012/13 and if it is to come in on 1 March 2016 it should at least be adjusted upwards by inflation.

Response: <u>Not accepted.</u> The monetary cap is an important mechanism to improve equity in the tax system for retirement contributions. Individuals on higher marginal rates of personal income tax receive a disproportionately higher benefit through a tax deduction. For this reason, tax deductions for medical scheme contributions and expenses have recently been transformed to medical tax credits, where the same benefit would be applicable to individuals with different levels of taxable income. There remain generous provisions which allow any contributions above the limit to be rolled over to the following year where they can be deducted in that year, and if there is no deduction on the contribution there would be no tax paid on those amounts when they are received as either a lump sum or as an annuity.

The 2011 Budget Review first proposed the introduction of a monetary cap on contributions of R200 000 (page 70). The 2012 Budget Review subsequently increased the proposed limit to R300 000 for those over the age of 45 (page 52). The limit was revised upwards again to R350 000 in the 2013 Taxation Laws Amendment Act for implementation from 1 March 2015. It is the intention to increase the limit from time to time to take into account the effects of inflation, but in the same fashion as other thresholds, any increase is done on a discretionary basis after approval from the Minister of Finance. The Minister of Finance will, however, review the current R350 000 limit for the 2016 Budget, which can still be implemented from 1 March 2016.

Comment: The media statement from National Treasury on 16 October 2014 indicated that there would be an attempt to reach agreement in NEDLAC by June 2015 or the implementation date may be moved to 1 March 2017. There has been no agreement in NEDLAC and the SCoF should consider extending the implementation date from 1 March 2016 to 1 March 2017 to allow proper process and consultation.

Response: <u>Not accepted.</u> There was no upfront commitment to extending the implementation date to 1 March 2017 if there was no agreement in NEDLAC, instead the media statement said a further delay would be considered as one of the options if an agreement in NEDLAC was not reached. The key point to note is that despite a number of meetings held in NEDLAC structures (Annexure E), no agreement has been reached, or is likely to be reached in 2016, until the social security reform paper is published and

there is agreement on the way forward. The current proposals are expected to be in line with the key objectives of social security reform. The majority of respondents were also not in favour of extending the implementation date to 1 March 2017 as it would create further uncertainty and sunk costs due to IT infrastructure improvements that would subsequently not be implemented.

Comment: National Treasury have stated that all statutory funds, except for the Government Employees Pension Fund (GEPF), will be treated the same as private sector funds. The thresholds for the deductibility of contributions will then not be applicable to the defined benefit members of the GEPF. It is not possible to justify that the legislation can be designed to specifically favour a select group, such as public servants.

Response: Comment misplaced. The proposed tax deductibility thresholds for contributions will apply to members of the GEPF and to all other members of defined benefit funds through a new section 12D in the Income Tax Act (which values the increase in the benefit for defined benefit fund members and treats that benefit increase as a contribution). It is not necessary to amend the legislation on annuitisation for the GEPF as the GEPF is a defined benefit fund and the benefit pay-outs to members at retirement are already in the form of an annuity. Excluding GEPF members from the requirement to purchase an annuity would not provide for any special treatment. Given the scope for misinterpretation of the coming reforms, government has opted not to amend the legislation given that the GEPF fully complies with current objectives of retirement reform.

2.2. Limitation of unwarranted relief from taxation in respect of foreign insurance by long term insurers

[Clause 53(1)(f) of B29 -2015; section 29A(11)(g) of the Income Tax Act]

Comment: In 2015, changes were made in section 29A(11)(g) of the Income Tax Act to limit the unwarranted relief from taxation in respect of foreign reinsurance. As a result, a proviso was added to section 29A(11)(g) to provide for the inclusion in gross income of reinsurance claims received by or accrued to an insurer in terms of reinsurance between the insurer and the non- resident with effect from 1 December 2014. The reference to reinsurance claims in the 2014 wording in section 29A(11)(g) created further loopholes. As a result changes were made in the 2015 Draft TLAB that was published for comment on 22 July 2015 later introduced in parliament on 27 October 2015 to replace the concept of reinsurance with insurance.

The proposed 2015 changes affected some of the existing policies. Only one of the thirteen comments received commented on this insurance-related amendment. In addition, the National Treasury received comments directly from a long term insurer in this regard. As a result, amendments were proposed to the Standing Committee on Finance on clause 53(1)(f) of the 2015 Draft Bill introduced in Parliament on 27 October 2015 to remove the 2015 proposed proviso and replace it with the proviso that was inserted in 2014.

Parliament received comments from another long term insurer (to the one submitting to the NT directly) opposing the proposed amendments to clause 53(1)(f) of the 2015 Draft Bill introduced in Parliament on 27 October 2015 on the grounds that it will result in a more onerous treatment of reinsurance contracts as compared to insurance contracts which would not be equitable, whereas both the above-mentioned contracts look very similar in substance.

Response: Partially accepted. Both National Treasury and SARS have evaluated the conflicting comments and come to the conclusion that the provision as introduced will be more effective in addressing the potential for tax avoidance and retaining equity across contracts entered into by long term insurers. It is therefore recommended that the proposed amendment to the Standing Committee on Finance on the introduced Bill not to be proceeded with and that the effective date for this proposal be the same as the effective date in the introduced Bill which is 1 January 2016.

3. Annexures

3.1. Annexure B

List of respondents to National Treasury Media Statement:
ABSA
Anglo American
Argen
Association for Savings and Investment South Africa
Congress of South African Trade Unions
FEDUSA
Financial Planning Institute
Goldfields
GTC
Institute for Retirement Funds Africa
KPMG
Large Employers Forum
Legal Aid
NACTU
Oasis
Old Mutual
Payroll Authors Group South Africa
PWC
South African Institute for Chartered Accountants
South Africa Institute of Tax Practitioners
SAMWU
South African Rewards Association
Sentinel Retirement Fund
Towers Watson
UTI

3.2. Annexure D

List of respondents to SCoF consultation:
Andrew Crawford
Association for Savings and Investment South Africa
Business Unity South Africa
Congress of South African Trade Unions
Institute for Retirement Funds Africa
Old Mutual
Payroll Authors Group South Africa
PWC
South African Institute for Chartered Accountants
South Africa Institute of Tax Practitioners
South African Rewards Association
Towers Watson

3.3. Annexure E

NEDLAC ENGAGEMENTS ON RETIREMENT REFORMS AND SOCIAL SECURITY

The following engagements took place within NEDLAC in respect of the above:

1. 26 October 2012
   - Government tabled retirement reform proposals in respect of retirement reform and preservation

2. Public Finance and Monetary Policy Chamber (PFMPC) agreed to establish a Retirement Reform Task Team

3. PFMPC Retirement Reform Task Team met as follows:
   - 07 February 2014
   - 06 March 2014
   - 19 March 2014 - Labour and Community said that they could not engage on the retirement reform proposals that were tabled by Government, until Government tables Comprehensive Social Security.

4. Manco Task Team on Comprehensive Social Security & Retirement Reform
   - 25 August 2015 – 1st Meeting of the Task Team
   - Labour stated that the Retirement Reforms should not be prioritised over the Comprehensive Social Security.

5. Engagement with Minister Nhlanhla Nene on the 2015 National Budget
   - 27 February 2015 – NEDLAC Exco resolved that there should be urgent engagement on the tax harmonisation proposals, which would align with an engagement on the comprehensive social security paper.

6. 7 August 2015
   - Tax Harmonization Workshop

7. Special Exco Session to engage on Medium Term Budget Policy Statement
   - 23 October 2015 – Minister of Finance again reiterated the urgent need for NEDLAC constituencies to engage and provide inputs on the tax harmonization proposals.