Implementing tax and harmonisation retirement reform

Presentation to Standing Committee on Finance

National Treasury | 15 October 2015

national treasury
Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

Two objectives: Tax AND Retirement Reform

- **Tax reform objectives**
  - Improving vertical equity between high and low income taxpayers by imposing a limit on the total allowable deduction to high income taxpayers and reducing the scope for structuring their tax affairs
  - Improving horizontal equity by harmonising the same deduction across ALL retirement funds and hence allowing equal treatment for all retirement funds
  - Improving transparency and data collection by deeming contributions by employers on behalf of members as a taxable fringe benefit
  - Simplifying the tax treatment of contributions to retirement funds (current system is complex and confusing)

Two objectives: Tax AND Retirement Reform

- **<u>Retirement reform objectives</u>**

- <u>Enhance post-retirement preservation</u> through extending the requirement to purchase an annuity to all retirement funds

  – Principle is that a tax deduction should be accompanied by annuitisation
  – All workers should be encouraged to save for their retirement hence the tax incentive
  – Some degree of annuitisation is essential to ensure that workers do not squander their hard earned savings within is short period after they have retired.
  – Also prevent family and friends from preying on those who retire with a relatively large lump sum
  – Need to ensure low cost retirement annuity products - - also consider living annuities
  – Future reforms to phase out the means test for the SOAG will also ensue that those saved are not penalised

Details of the reforms that were legislated in 2013

- **Treatment of contributions**:
  - Employer contributions to *any retirement fund* treated as a fringe benefit and taxable in the hands of employee, <u>if above the caps</u>
  - Exemption for employer & employee contributions, up to a percentage ceiling of 27.5% of taxable income or remuneration and up to a R350 000
  - Same treatment across all retirement funds

- **Treatment of benefits**:
  - Phase in annuitisation of 2/3rds of provident fund benefits, similar to pension and retirement annuity funds from 1 March 2016
  - <u>Vested rights are protected</u>
    - No annuitisation for those in provident funds over the age of 55 (including for future contributions)
    - For those below 55, no annuitisation on amounts in provident fund at 1 March 2016 and growth on those amounts
  - *de minimus* annuitisation requirement raised from R75 000 to R150 000

Concerns within labour constituency

- Workers prefer provident funds: requirement to annuitise will effectively change or phase-out provident funds
  - Govt view that preservation and annuitisation good for workers, and open to remove means test for old age grant when affordable in next few years

- Resignations: retirement reforms were causing misinterpreted as nationalisation of retirement funds with Government denying workers access to their retirement savings before retirement
  - Govt attributes resignations (based on subsequent data) to GEPF members mainly, due to high indebtedness as TLAA 2013 did not change the law for pension funds like GEPF

- Publication of social security paper: Labour and Community constituencies of NEDLAC argue retirement reforms are "piecemeal" and cannot engage in the absence of the social security paper

National Treasury consultations

- NT has to date held several meetings with NEDLAC constituencies, labour unions/Federations and some of their funds at official and political level
  - 40 meetings since June 2012
- The response within labour constituency is a refusal on retirement reforms without the social security paper being released
- Options Govt put forward to get more consensus:
  - <u>Increase *de minimis* </u>threshold to be higher, so that most workers not affected
    - Media statement for 2016 TLAB in July suggested this option

Meetings / engagements with NEDLAC and labour this year

1	29 January 2015	Nedlac	Organised labour conference
2	27 February 2015	Nedlac	Minister's post 2015 Budget engagement
3	22 July 2015	Nedlac	PFMP Chamber Meeting (Retirement Reforms)
4	7 August 2015	Nedlac	Tax harmonisation workshop
5	25 August 2015	Nedlac Manco	Tax Harmonisation
6	30 September 2015	Nedlac Task Team	Social Security & retirement reforms
7	7 August 2015	COSATU	Meeting with DG of NT
8	10 October 2015	NACTU	TLAA 2013
9	12 October 2015	FEDUSA	TLAA 2013

Tax reforms to proceed, two options for annuitisation

- Tax reforms will be implemented as scheduled on 1 March 2016 through the 27.5% or R350 000 cap
  - Equity objectives cannot be further delayed
- On retirement reform related to annuitisation of provident funds, Minister of Finance is proposing a meeting with NEDLAC labour constituency next week to consider two options
  1. Keep current legislation but increase thresholds to mitigate the potential impact on provident fund members
  2. Delay the requirement for provident fund members to purchase an annuity on retirement
- Under Option 1 an increases in the de-minimus annuitisation threshold would mean that many provident fund would not be required to purchase an annuity as their retirement assets would be below the limit
- Under Option 2 the requirement to purchase an annuity would be delayed
  - A limited tax deduction would be available in the interim for provident fund members

Details of the second option to be considered

- Limit the deduction for provident funds at a level lower than 27.5% since provident funds are not required to annuitise
- Propose a tax deductible limit of 10%-15% for provident fund contributions
  - Include both employee and employer contributions within the 10%-15% limit
    - Will improve fairness between all members of provident funds (especially those who cannot structure their pay package)
- To mitigate impact on lower income members, allow up to R30 000 to be contributed, regardless of the limit
  - For example, individual on R100 000 with a 20% contribution of R20 000 would not be impacted
- Maximum rand contribution limit of R125 000 for consistency with other reforms
  - Same proportion as the R350 000 cap for pension funds and RAs

- Full vested rights and new transfer regime would apply when annuitisation is introduced

Harmonisation of provident funds

- As part of the 2015 draft TLAB it was proposed that all retirement funds should be treated in the same manner
  - There are some provident funds that are treated as pension funds in terms of the Income Tax Act
  - It is proposed to move these provident funds from the pension fund definition to the provident fund definition

Annex: Example of how the new deductibility limit compares

- Current deductibility limits refer to ‘retirement funding employment income’ and ‘non-retirement funding employment income’
  - Retirement funding employment income could be between 60-100% of remuneration
  - Deductibility limit for employer contributions for pension and provident fund is legislated as 10% of ‘retirement funding employment income’ (discretion by SARS to allow a higher deduction)
  - New base to calculate limits includes employer contribution and based on higher of taxable income or remuneration

Annex: Example of how the new deductibility limit compares

	Current limit	New limit
Taxable income	250 000	250 000
RFEI %	80%	80%
RFEI	200 000	200 000
Employer contribution %	10.5%	10.5%
Employer contribution	21 000	21 000
BASE	200 000	271 000
Employer contribution % for limit	10.5%	7.75%