national treasury
Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

MEDIA STATEMENT

URGENT REQUEST FOR PUBLIC COMMENT ON THE TIMING OF UNIFORM TAXATION AND ANNUITISATION FOR RETIREMENT FUNDS IN THE TAXATION LAWS AMENDMENT BILL, 2015

The National Treasury today releases for urgent consultation, amendments on the timing of annuitisation for provident funds in the 2015 Taxation Laws Amendment Bill ("2015 TLAB"), as tabled by the Minister of Finance in the National Assembly in Parliament. The Bill and explanatory memo released by Parliament today will also be available on the National Treasury website.

Consultation on retirement-related reforms

The proposals to improve retirement tax incentives, harmonise and simplify the taxation of retirement contributions and benefits, including the need to annuitise benefits under provident funds, were legislated through the Taxation Laws Amendment Act No. 39 of 2013 ("2013 TLAA"). Extensive public consultations were held, including dedicated sessions with labour unions, before the promulgation of TLAA 2013. These changes were initially scheduled to be implemented on 1 March 2015.

Government will be proceeding with the tax reform enacted in 2013 and 2014 for equity between high and low income tax payers, by extending the tax deduction benefit to provident fund members, and limiting the deduction to the lesser of 27.5% of taxable income (remuneration) or R350 000. This is achieved by harmonising the tax treatment of all contributions to retirement funds, irrespective of whether they are provident, pension or retirement annuity funds.

The further consultation on the 2015 TLAB is limited to whether, and for how long, the annuitisation of provident funds should be delayed. It is the intention of Government that ideally, the tax deduction of retirement fund contributions must be related to annuitisation, to reduce vulnerability in retirement by ensuring a secure monthly income for members in retirement. Though current and recent legislation does not deal with preservation, it is the intention of Government that ultimately, the rationale for the tax deduction on retirement contributions is to encourage taxpayers to save for their retirement. Government has also previously indicated that once affordable to the fiscus, it would consider reforming the "means test" as it applies to old age grants to ensure that those who annuitise can also qualify for such benefits.

At the request of some members of the Labour constituency at NEDLAC during 2014, the retirement-related reforms in the 2013 TLAA were postponed by a year to 1 March 2016 to allow for further consultations between Government and NEDLAC. The process of consultation has not been concluded in time for the 2015 TLAB. Government intends to complete the consultation process in the next week in order to ensure that the 2015 TLAB contains the final set of legislative amendments required to implement the reforms.

The Government is consulting over the following options related to the timing of annuitisation of provident funds, which are covered by clauses 3(k) to (z) and (zB to cD) on pages 4-10 of the 2015 TLAB tabled by the Minister of Finance in the National Assembly today, 27 October 2015. These clauses are drafted in a way to give effect to the specific option that will be recommended by Government after the consultations. The specific proposal is expected to be discussed at the Standing Committee of Finance Parliamentary hearing on the 2015 TLAB on 4 November 2015. It contains within it two options to consider:

Option 1, which is the preferred option of the National Treasury and many stakeholders (including some labour federations), entails proceeding with TLAA 2013 tax and retirement reform provisions on 1 March 2016 as legislated, with the only adjustment being to increase the *de minimis* to R250 000. Contributions by employers to pension, provident and retirement annuity funds on behalf of employees will become a taxable fringe benefit. Further, vested rights are preserved and those over 55 years are exempted from the requirement to annuitise. The higher *de minimis* from R75 000 to R250 000 will effectively mean that many members of provident funds who do not have a retirement benefit exceeding R250 000 will not need to annuitise, and in the event that they need to annuitise, it will take several years before their savings would reach R250 000.

Option 2 proposes a phased-in approach for annuitisation, together with limits to the tax deduction for member contributions from year 2 onwards if there is no annuitisation, and other adjustments, as follows:

a. ***Year 1: 2016 and adjustments***

   TLAA 2013 will come into effect for all retirement funds (including provident funds), with the total tax deductible retirement contributions capped at the lesser of: 27.5% of the greater of taxable income (remuneration) or R350 000. Provident funds will **not** be required to annuitise. The *de minimis* will be further increased to R250 000 for all retirement funds. These adjustments will deal with concerns around late adjustments to legislation, the short consultation period and related systems implication.

   Year 2: 2017 and adjustments

   As from 1 March 2017, the waiver of annuitisation for provident funds will continue, but the tax deductible retirement contributions for provident funds will be capped at the lesser of: 10% of the greater of taxable income or remuneration; or R125 000.

   Important: this provision in the TLAB 2015, or year 2 (i.e. 2017) and its adjustments, will fall away if there is agreement on the need to annuitise for provident funds in 2016. This would mean that the requirement to annuitise for provident funds will come into effect in

2017, including also the higher tax deductible contribution rate of 27.5% (up to R350 000).

b. ***Year 3: 2018***
Full alignment between provident, pension and retirement annuity funds. This means that provident funds will be required to annuitise, as with other retirement funds. Full vested rights, as legislated in TLAA 2013, will apply.

<u>Important</u>: Year 3 will depend on whether the agreement to annuitise is reached or not in 2017. If no such agreement is reached, then year 2 with its adjustments continues.

Government will only consider this second option if the benefits of this option are clearly demonstrated for members of provident funds, as the priority for Government is to act in the interest of the member. The period for any delay will also need to be motivated.

Encouraging annuitising and preservation in the future

National Treasury remains committed to incentivising retirement savings subject to the principles of annuitisation and preservation. If members want to enjoy higher tax deductions for retirement contributions, then they should be expected to commit to annuitisation (two-third) with one third-lump sum, the same benefits offered by pension funds (and retirement annuities). Both retirement annuities and pension funds protect members from old-age poverty associated with rapid spending of cash-lump sums in retirement. In future, the tax deduction system will also be linked more closely with the objective of preservation, taking into account factors relevant to South Africa such as lack of job security and high unemployment. It should be noted that these objectives still allow for lump sum withdrawals, but restricted to a third.

National Treasury also prioritises the reform of the annuities market, which has challenges with providing annuities, especially guaranteed (life) annuities, to low-income retirees. Innovative ways need to be considered for the system to be able to provide cost-effective annuities to most retirees. The recently released draft default regulations (available on the treasury website) for retirement funds seek to partly address these challenges, but industry is encouraged to consider new and cost-effective (hybrid) products which take better account of retirees' needs. National Treasury will also continue with its reforms to open-up the industry by allowing also other players, beyond insurance companies, to offer cost-effective annuities.

Process

Urgent comments on the relevant provisions in the Bill relating to only the issues above are invited and should be sent to Ms. Alvinah Thela, Director for Retirement Funds, Private Bag X115, Pretoria, 0001; or fax to (012) 315 5206; or per email to retirement.reform@treasury.gov.za, by **2 November 2015**. Meetings will also be arranged with key stakeholders by end of this week.

Background on retirement reforms related to the uniform tax treatment of contributions

There are three basic types of retirement funds in the South African retirement system: pension, provident and retirement annuity funds.

Employer contributions to pension funds and provident funds are currently a non-taxable fringe benefit, and are a deductible business expense up to certain limits. Member or employee contributions to pension funds or retirement annuity funds are tax deductible (subject to limits) for personal income tax purposes. However no tax deduction is available for member contributions to provident funds. Pension and retirement annuity fund members are required to annuitise a portion (usually two-thirds, with one-third still a lump sum) of their retirement fund saving or interest upon retirement. However, provident fund members are not required to annuitise any portion of fund savings at retirement. As a result, provident fund members typically receive their retirement benefit as a lump sum upon retirement, and tend to spend it quickly and, therefore, be vulnerable to old-age poverty.

Further, since the employer contribution to a provident fund is a tax-free fringe benefit, employers of high-income members of provident funds make large contributions (and thereby enable such members a benefit from non-taxable income) on behalf of these members who are entitled to large lump sums at retirement without the requirement to annuitise. The different treatment of the various retirement funds creates complexity for both contributors and administrators, and increases the scope for structuring and tax avoidance by high income earners. This complexity and avoidance contributes to costs, and also makes enforcement by SARS difficult.

Objectives of retirement reform

The retirement reform and tax provisions contained in 2013 TLAA sought to achieve four critical objectives; (i). Simplify and align the tax treatment of contributions to retirement funds; (ii). Improve both horizontal and vertical tax equity, by allowing the same tax deductions across all retirement funds and imposing a limit on the total allowable deduction; (iii). Improve transparency and data collection by deeming contributions by employers on behalf of members as a taxable fringe benefit; and (iv). Protect retirees against old-age poverty by extending the requirement to purchase an annuity to provident fund members. The above objectives remain valid and important.

Concerns raised on retirement reform

Various concerns have been raised by some members of NEDLAC's Labour constituency regarding the retirement reforms, and specifically their implication for provident funds.

The end of provident funds: Certain labour federations have argued that the reforms will mark the end of provident funds, especially if they are to be required to annuitise. They argue that workers fought hard during the apartheid years to have provident funds, mainly for black workers who were excluded from participating in retirement funds. At a social level, it has been argued that the requirement to annuitise could be less cost-effective for low-income members, and that many members use their cash lump sums to invest in a new business, defray debt or invest in a house. There is also an argument that workers who go to rural areas upon retirement, are unable to annually confirm their continuing membership and also have little or no access to banking facilities to receive their monthly annuity payment.

Government's view is that these reforms are meant to transform provident funds to serve their members better. Secondly, the vested rights will enable current members to still be able to take their retirement benefits as a cash lump sum at retirement. Lumps sums will still be allowed up to one-third of the retirement benefit, with annuitisation of at least two-thirds. Further, Government will continue to engage with the industry to enable appropriate and cost-effective annuities.

<u>Resignations:</u> The annuitisation requirement for provident fund members has been misinterpreted as nationalisation of their retirement funds or as Government denying members access to their retirement funds prior to retirement. This has resulted in a number of Government employees who are members of Government Employees Pension Fund (GEPF) resigning to prematurely have access to their retirement savings. As Government has strongly pointed out, rumours of nationalisation were incorrect, and further the 2013 legislation did not affect the GEPF and pension fund members. Further, although Government would like to encourage preservation, the legislation does not affect access to retirement savings when a member resigns or changes jobs.

Statistics received from various private-sector administrators, including Government Pension Administration Agency (GPAA)/(GEPF), appear to confirm that the resignations have been largely concentrated within the national and provincial Government sector, mainly members of the GEPF who are teachers, nurses and police. It is National Treasury's view that such resignations are caused by the high-indebtedness of Government employees, and not the retirement reforms. This view is further informed by the fact that the requirement to annuitise provident funds' benefits in retirement does not affect the GEPF, since by virtue of being a pension fund, the GEPF has always applied and continues to apply the annuitisation requirement as per its rules.

<u>The publication of the social security reform paper:</u> The Labour and Community constituencies at NEDLAC have strongly demanded that Government release the social security reform paper to enable more informed debate of retirement reform. They have argued that retirement reforms present a "piecemeal" approach in the absence of having sight to the complete proposed design of a social security system. Government is committed to the release of the paper, but has pointed out that the work and processes related to the paper have taken longer than anticipated. Government has also argued that retirement reform should not be delayed, as it works against the interest of members. It is still expected that the paper will go through the necessary Government processes and be publicly released soon. The reforms under 2013 TLAA 2013 are fully consistent with the objectives of social security reform.

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