

Advantages of the tax and retirement reforms contained in the Taxation Laws Amendment Bill 2015

Background

The Treasury commenced the reform of the retirement industry in 2012, when it requested Cabinet approval to publish a number of key papers to improve the private retirement industry. The published papers dealt with the need for good governance, the challenge of certain inappropriate and inadequate annuities, the high costs for certain retirement services and products, the importance of discretionary savings and simplifying the taxation of retirement contributions. The Financial Services Laws General Amendment Act of 2013 addressed some of the governance concerns. National Treasury has had extensive consultations with trade unions and industry stakeholders, after which the first set of reforms were enacted into law in 2013, through the Taxation Laws Amendment Act (TLAA 2013) and the Financial Services Laws General Amendment Act (2013).

Challenges in the current retirement system

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 and 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 available as 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 contributions 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.

The benefits of the tax and retirement reforms

The reforms contained in TLA 2013, which are meant to take effect on 1 March 2016, limit the tax deduction per annum to 27.5% or R350 000, whichever is lesser, of the greater of taxable income or remuneration. These reforms are meant to achieve the following important objectives and benefits:

- Allow provident members, for the first time, a tax deduction for their own contributions, and thereby increasing their take home salaries.
- SARS data shows that there are over 2.5 million provident fund members who contribute to a provident fund. Around 1.25 million are above the tax threshold and would receive an increase in net pay.
- Encourage workers to save and save more for their retirement because of the higher tax deduction limits for contributions.
- Protect retirees against old-age poverty by extending the requirement to purchase an annuity to provident fund members.
- Improve 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 and thereby benefiting excessively from the tax deductions.
- Improve horizontal equity by harmonising the same deduction across all retirement funds, and hence allowing equal treatment for all retirement funds.
- Improve transparency and data collection by deeming contributions by employers on behalf of members as a taxable fringe benefit. This will enable better administration and enforcement by SARS.
- Simplify the tax treatment of contributions to retirement funds (current system is complex and confusing). TLA 2013 also does away with the misleading and restrictive concept of pensionable salary; the new limits will apply on taxable income or remuneration, and not pensionable salary.
- Vested rights are protected, resulting in the impact of annuitisation taking longer to be felt by provident fund members (even though the effective date is s1 March 2016, members will not have to annuitise immediately).

Progress to date

Pension Funds Act amendment (through Financial Services Laws General Amendment Act No 45 of 2013) to strengthen governance in retirement funds:

- Whistle-blowing protection for Board members, valuers, principal/deputy officers, and employees who disclose material information to the Registrar (FSB).
- Fund board members/trustees to attain skills and training as prescribed by the Registrar, within 6 months.
- Criminalisation and extending personal liability to employers in respect of non-payment of pension contributions to a pension fund.

- Protection for board members/trustees from joint and several liability, if they act independently, honestly and exercise their fiduciary obligations.
- Require pension funds to notify the Registrar of their intention to submit an application to register prior to commencing the business of a pension fund.
- Trustees to exercise fiduciary duty towards fund and members, and ensure proper governance.

Taxation Laws Amendment Act No. 31 of 2013

- Same tax dispensation for all contributions into retirement funds (retirement annuities, pension funds and provident funds)
- Annuitisation of benefits from provident funds (vested rights protected)
- Threshold to purchase an annuity increased from R75 000 to R150 000
- Tax free lump sum at retirement increased from R315 000 to R500 000 in 2014

Taxation Laws Amendment Bill, 2015

- The proposed amendments to the Taxation Laws Amendment Bill, 2015 revert back to the amendments for retirement funds contained in the Taxation Laws Amendment Act, 2013, with a higher threshold to purchase an annuity of R247 500.
- The following documents provide additional support to the Response Document and the document motivating the amendments in terms of the Money Bills Amendment Procedure and Related Matters Act, 2009 for the implementation of the tax harmonisation components of the retirement reforms. These documents are
 - Annexure A: Question and answer document
 - Annexure B: Impact of annuitisation on provident fund members
 - Annexure C: Data on provident fund members, retirement values and impact on net pay
 - Annexure D: Response table for National Treasury retirement reform consultations