national treasury
Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

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ANNEXURE A: Question and answer document

1. Which tax laws is the Government passing that affects retirement policies?

The Government is updating a law it passed in 2013 (in the 2013 Taxation Laws Amendment Act) that harmonised the tax treatment of contributions to retirement funds. Different types of retirement funds have different tax rules, and provident fund members enjoy no tax deduction for their contributions. Government also noted that high-income taxpayers also structure their salary packages to enjoy relatively high tax deductions, since employer contributions are not currently a taxable fringe benefit for the individual and are not recorded in tax returns. The 2013 law therefore harmonises the remuneration base for tax purposes for all retirement funds, and consolidates both employer and employee contributions to reduce the scope for tax structuring.

The 2013 law allows for a 27.5% tax deduction up to a maximum of R350 000 per annum. The key condition for enjoying the tax deduction is that members take a lump sum up to one-third, with the rest to be annuitised. This law should have been implemented on 1 March 2015, but was delayed by one year to take account of concerns raised by some stakeholders, including COSATU. The only change to the law that Government is considering this year is to confirm that the new law will take effect on the scheduled date of 1 March 2016 alongside an increase in the threshold above which members are required to purchase an annuity.

2. How will the tax and retirement reform benefit workers?

It is envisaged that workers will be encouraged to save (more) through retirement funds, to curb old-age poverty and excessive dependency on relatives. Members of provident funds will, similar to members of pension and retirement annuity funds, be able to claim a tax deduction on their contributions to their funds. There are over 2.5 million provident fund members who contribute to a provident fund. Around 1.25 million are likely to see an increase in their take home salaries, and many more will receive the tax deduction if they decide to save more for their retirement. Lastly, low savings can also result in excessive indebtedness, as individuals have to borrow to meet unexpected expenditure.

3. Will these changes make the tax system more equitable and progressive?

Yes, it will. The Government is concerned about tax avoidance structuring where high-income taxpayers are able to structure their remuneration packages to reduce their tax liability out of proportion to what Government considers to be fair. The abuse/avoidance is mainly by high income earners in provident funds, who exploit the fact that the employer contribution is a non-taxable fringe benefit, and hence have funds where employers make a 20 to 30% contribution with no contribution from the member.

The 2013 law, when implemented, will make the tax system more progressive, by improving vertical equity between high income and low income taxpayers, as it limits the tax deduction to R350 000. It will also improve horizontal equity by harmonising the same deduction across all retirement funds.

Since the purpose of the tax deduction is to encourage savings for retirement, it is important that the tax deduction is only available to members of a fund who intend to annuitise on retirement (even though the current changes to the law do not deal with preservation before retirement).

4. What are the objectives of the tax and retirement reforms?

The reforms seek to achieve the following: (1) Simplify the tax treatment of contributions to retirement funds (current system is complex and confusing); (2) Improve vertical equity between high and low income taxpayers by imposing a limit on the total allowable deduction to high income taxpayers; (3). Improve horizontal equity by harmonising the same deduction across all retirement funds; (4) Enhance post-retirement income by extending the requirement to purchase an annuity to provident funds. (5) Vested rights are protected, ensuring that the impact of annuitisation takes longer to be felt by provident fund members.

The Government is encouraging everyone who has a job or income to save for their retirement, and does so by allowing a tax deduction up to 27.5% of income (up to R350 000) on all contributions made towards a retirement fund. The Government also wants to be fair and allow this benefit to all members of any retirement fund –whilst members of pension and retirement annuities enjoy this benefit for their own contributions members of provident funds do not.

5. How will the new legislation apply to provident funds?

The effect of the alignment between provident and pension funds will take a long time to have an impact on members, and will not affect provident fund members who are currently close to retirement. All provident fund members will still be able to take all their retirement savings that would have been accumulated as at 1 March 2016 as a cash lump sum whenever they go into retirement.

The conversion of a portion of the retirement money into income at retirement will only apply to <u>new</u> contributions made by those who are <u>younger than 55</u> when the legislation comes into effect. This means that members who are 55 years and older on 1 March 2016, when the law comes into effect, will not be affected, i.e. they will still be able to even take (new) contributions made after the legislation has come into effect as a cash lump sum in retirement.

Workers who are below 55 years on 1 March 2016, will not be asked to annuitise or take a pension on the portion of new contributions if the total of those accumulated savings are R247 500 or less ("*de minimis* rule") when they reach retirement. Irrespective of age, whatever a member has accumulated in the provident fund as at 1 March 2016, and the growth on those amounts will be available to them as a cash lump sum when the person retires (i.e. protection of vested rights). For most low- and middle-income workers, it will take several years (more than five up to fifteen) years to reach the above threshold, and hence many years before they are asked to annuitise at retirement.

6. Why should provident funds members not worry about the changes?

The first point to make is that the reforms do not take away the right of provident fund members to their benefits before or at retirement. Instead, the reforms enable a <u>slower use</u> of such benefits in retirement, by requiring annuitising from a certain amount. The data indicates that 83.5% of provident funds members fall in the R160 000 and below income bracket, and that the majority of them retire with an average retirement benefit of R300 000 (note that this average includes higher income members). These data, coupled with protection of vested rights and a higher *de minimis* amount of R247 500 (i.e. the amount below which you do not require annuitising) leads to the second point that most, if not all, low income earners approaching retirement in <u>at least</u> the next two to five years (and longer), will not be required to annuitise.

7. Will members have access to their pension or provident fund upon resignation or losing a job?

Yes. The implementation of the Taxation Laws Amendment Act will not take away the right of provident or pension fund members to withdraw their benefits before or at retirement as a lump sum. Contrary to false rumours, Government has NO intention to take-over the hard-earned deferred income of workers, whose funds will remain under the control of their trustees. Government has also improved the law to ensure better governance practices by trustees, and intends to strengthen these further. Further, with the full support of all labour unions, Government (as part of its retirement reform programme):

- Passed a law in 2013 to criminalise the non-transfer/payment of member contributions to the fund;
- Initiated policy discussions on the lowering of high charges, and the selling of inappropriate annuities by the retirement industry.

8. What happens if a member of a provident fund wants to access his/her retirement benefit upon resigning?

Members will be able to take all their retirement savings as a cash lump sum upon resignation (with tax implications). However, members of both pension and provident funds are encouraged to keep their savings until retirement (i.e. preserve their savings), and Government intends to ensure that members seek proper financial advice from their pension and provident funds before withdrawing such funds. Government is also concerned that many workers are highly-indebted, and should not risk their secure jobs by resigning from their work to access their savings.

9. Does the new law mean that provident funds will be abolished?

The Government recognises the hard-won rights to secure provident funds for workers. Provident funds will continue to exist, but will evolve in the long term to have the same tax treatment of contributions and benefits as pension funds, i.e. a one-third retirement lump sum and a requirement to buy an annuity with the remainder if above R247 500. Current members of provident funds will still be entitled to take their contributions up to 1 March 2016 plus growth (vested rights) as a cash lump sum.

10. What are the economic implications of retirement reform?

South Africa has had a persistently low savings rate in the last two decades. In 2014, our gross (i.e. household, government and corporate) savings rate stood at about 15% of GDP. The low savings rate is even more pronounced for households, whose savings rate in 2014 stood at 0.1% of GDP. Countries like Brazil, Russia, India and China recorded higher gross savings rates of between 18% and 50% for 2013. Low savings create a shortage of funds for investments, resulting in South Africa having to rely excessively on volatile short-term capital inflows, which can affect the Rand's purchasing power. Secondly, low savings rate create a funding gap for investments – investments are important for economic development and growth. The National Development Plan acknowledges the importance of higher savings and investments in promoting economic growth in the country.