national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

Questions and Answers (Q&A)[1] 3rd December 2015
Tax harmonisation and retirement reforms

1. What are the changes that will come into effect on 1 March 2016?

The Taxation Laws Amendment Act, 2013 will come into effect on 1 March 2016. This law allows for a 27.5% tax deduction up to a maximum of R350 000 per annum for all retirement fund contributions. 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. Further, the new law passed in Parliament has increased the amount required for annuitisation at retirement from R150 000 to R247 500, closes certain coverage gaps; and requires a review of the legislation after two years from the effective date, and to report this review to Parliament .

2. What is an annuity?

An annuity is income earned in retirement from the retirement savings one would have accumulated over ones working life.

3. How much of one's retirement benefits needs to be annuitised after 1 March 2016?

For pension funds and retirement annuity funds, there will be no change. For provident funds, one third of the retirement benefit lump sum may be taken as cash and the remaining two thirds has to be annuitised with respect to contributions made after 1 March 2016 for those below 55 years of age. For example, with a retirement benefit of R300 000, the amont that may be taken as a lump sum is R100 000 and R200 000 would have to be annuitised, meaning the member would get a monthly income from this.

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

Members of provident funds will, in a similar treatment of members of pension and retirement annuity funds, be able to claim a tax deduction on their contributions to their funds. Also, the contributions their employers make to their provident funds will become visible on their payslips. Most fund members who make contributions to their provident funds, except the very highly paid, will see their take-home pay increase as a consequence. Further, all new contributions into provident funds after 1 March 2016 by those younger than 55 years, and the growth on these contributions, will be subject to the annuitisation requirement once the value when they retire exceeds the *de minimis* threshold noted below. All provident fund members will still be able to take all their

[1] To be updated from time to time

retirement savings that would have been accumulated as at 1 March 2016, and the growth thereon, as a cash lump sum when they go into retirement.

The conversion of a portion of the retirement money into income at retirement will only apply to new contributions made by those who are younger than 55 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.

Fund members 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 fund members, it will take several years (more than five up to fifteen) years to reach the *de minimis* threshold, and hence many years before they have to annuitise at retirement.

5. 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 take their benefits before or at retirement. Instead, the reforms enable a slower use of such benefits in retirement, by requiring annuitising from a certain amount. The data indicates that 83.5% of provident funds members earn R160 000 or less, and that the majority of these retire with an average retirement benefit of R300 000 or less. 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) mean that most, if not all, low income earners approaching retirement in at least the next two to five years (and probably much longer), will not be affected by the annuitisation requirement.

6. 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 of 2013 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 retirement savings of fund members, 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, Government has, 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 certain inappropriate annuities by the retirement industry.

7. **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, resulting in major 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 receive proper financial advice from their pension and provident funds before withdrawing such funds. Government is also concerned that many fund members are highly indebted. Such fund members should not risk their secure jobs by resigning simply to access their savings.

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

The Government recognises the hard-won rights to secure provident funds for fund members. Provident funds will continue to exist after these reforms. Over the very long term, they will evolve to have the same tax treatment of contributions and benefits as pension funds, i.e. tax -deductible contributions and a one-third retirement lump sum and a requirement to buy an annuity with the remainder. This evolution will take many years, as 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.

9. **How will the tax and retirement reform benefit fund members?**

After the reform, 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. Once the reforms have bedded down, which may take many years; retired members of provident funds will be less vulnerable to poverty in old age, and less reliant on their relatives for support. This is because they will only be able to access their retirement savings more slowly once they have retired.

10. **What is T-Day and has it come to effect?**

T-day is the day when the harmonisation of the tax treatment of retirement contributions is to be introduced. This T-day will officially be on 1 March 2016. From this date most taxpayers, to their benefit, will be able to deduct a higher amount in contributions from their income. T-day is also the day when the alignment of the payment of benefits from provident and pension funds comes into effect, subject to the protection of vested rights as detailed below.

11. **What does ‘protection of vested rights’ mean?**

Protection of vested rights means that all accumulated retirement savings in retirement funds on the date of implementation of the Taxation Laws Amendment Act No. 39 of 2013 (i.e. 1 March 2016), as well as growth on these amounts, will not be required to be annuitised upon retirement. For those older than 55 who are members of provident funds on 1 March 2016, contributions made after 1 March 2016, and growth on these, can be taken as a lump sum.

Further, these accumulated savings – in respect of contributions made before or after 1 March 2016, for fund members younger or older than 55 on that date – can be withdrawn upon resignation, although such pre-retirement withdrawal is discouraged.

12. **Can members of provident funds transfer their vested amounts to another fund?**

Vested rights for provident fund members who are 55 years and older on 1 March 2016 will be fully protected if they remain in the same fund. However, if the member decides to transfer to another fund, they would be required to annuitise two-thirds of any future contributions to the new fund. A 55 year old that changes funds, for example in June 2017, will have amounts accumulated till then as a vested right and those amounts can be preserved in the same fund or transferred to another. However, new contributions from there on will not enjoy the vested right.

13. **Why is Government aligning provident fund benefits with those received from pension and retirement annuity funds?**

To help retirees from provident funds to better manage longevity risk (i.e. the risk of outliving retirement savings when in retirement) and investment risk (i.e. the risk of up and down movements of market prices in securities), and prevent them from spending their retirement assets too quickly and becoming excessively reliant on the State or their families for support.

14. **Will members contributing to a pension fund be affected by the reforms?**

For fund members contributing less than R350 000 and 27.5% of remuneration there will be no changes, in terms of deduction and take-home salary. However, they can take advantage of the higher tax deductions and contribute to retirement annuity policies for retirement purposes. For fund members contributing more than these thresholds, there may be a fall in take-home salaries, depending on how much they contribute and how much they earn. There will not be any changes for those retiring from pension funds, if the pension fund pays a pension or requires members to purchase an annuity. The pension fund status quo will then remain in terms of the annuitisation requirement (i.e. getting a pension when one retires).

15. **Do the retirement reforms affect members of a pension funds, retirement annuities and the Government Employees Pension Fund (GEPF)?**

Pension funds and retirement annuities are already required to annuitise two-thirds of retirement benefits and hence will not be affected by the 2013 or 2015 laws. The Government Employees Pension Fund (GEPF) is a pension fund, and hence will also not be affected by the 2013 or 2015 laws. However, GEPF members will be subject to the same tax deductibility limits on retirement contributions contained in the above tax legislation. The rules applicable to the GEPF will continue to apply, as is the case for most pension funds.

It should be noted that all members of pension funds will also benefit from the 27.5% tax deduction, up to a limit of R350 000. Except for very high-income taxpayers who tended to claim a higher than proportionate deduction, this limit will, in most cases afford members of pension funds to save more through a retirement fund.

16. Is Government going to take away or deny members access to their money?

No. Government has had a long-run intention to introduce some kind of preservation requirements (see below). However, any such introduction will take full account of vested rights. Further, there is no intention by government to nationalise fund members' pension/provident funds, or to prevent them from accessing their money. Instead, government is proposing important measures to encourage fund members to keep their savings until retirement, and to convert some of these funds into income at retirement. Fund members who panic and resign to access their pension savings will be losing secure jobs and placing their well-being in retirement at peril for no reason.

17. How do the reforms affect members that take early retirement or get disabled or deceased?

A person that takes early retirement, or gets disabled or deceased will be paid out their retirement benefit in terms of the rules of the fund they are contributing into.

18. 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 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 members of a fund annuitise on retirement. (Note that the current changes to the law do <u>not</u> deal with preservation before retirement).

19. 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) Protect vested rights, and thereby ensure 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 currently do not.

20. What is preservation?

Preservation is when money saved for retirement through pension, provident and preservation funds remains in those funds until the person retires, or is rolled over or transferred into another similar retirement savings vehicle.

21. Why is Government encouraging preservation?

People tend to change jobs a number of times in their working lives. Every time an employee changes employment, they tend to cash in their accumulated retirement savings, thereby retiring with insufficient retirement benefits. Cashing in before retirement also prematurely erodes security in old age, undermines the alleviation of poverty and increases reliance on others for support.

22. When will preservation come into effect?

Preservation is expected to be introduced in the future. Whatever form it will take, it will not be full preservation; i.e. fund members will still be allowed to access some of their money before retirement. Full vested rights will also be granted. A date for effecting preservation has not yet been announced,as there is still no policy decision on the exact and final nature of the preservation rules. Preservation is still a proposal that is open for public comment and debate. Before any form of preservation comes into effect, legislation will still be made available for public comment before being passed into law.

23. Where can fund members find information about the retirement reforms?

Members may find information from, firstly, from their own fund principal officers, and trustees. Additional information may be obtained from the National Treasury website by following this link: http://www.treasury.gov.za/publications/RetirementReform/