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2 November 2015

Dear Alvinah

URGENT REQUEST FOR COMMENT ON TIMING OF UNIFORM TAXATION AND ANNUITIZATION FOR RETIREMENT FUNDS

We refer to the Taxation Laws Amendment Bill, 2015 ("TLAB") tabled in Parliament on 24 October 2015, the Memorandum and the Media Statement, as well as our letter dated 21 October 2015.

The media statement requests urgent comment on the timing of the uniform taxation and annuitization of provident funds, and gives two options for consideration. At the meeting called by National Treasury on 30 October 2015, three variations of Option 2 were discussed. Our comments on both Options and the variations, follow.

PRINCIPLES

As matters of principle, we wish to emphasise the following:

- ASISA members have always supported annuitization and would like to see the introduction of measures for the preservation of withdrawal benefits and mandatory contributions to retirement funds, as soon as possible. As we have said in the various submissions made on retirement fund reform, the reduction of "leakage" from retirement savings is clearly the right path to be followed, and together with various other proposed interventions, will enhance retirement savings and facilitate the reduction of costs.
- Although reforms are desirable where they will achieve the objectives of consolidation, simplification and enhancement of retirement savings, they need to be introduced in an orderly manner with plenty of lead-in time to allow administrative and systems measures to be put in place together with the communication to and education of fund members, fund trustees, advisers, consultants and staff.
- Certainty as to what the system intends to achieve and what the rules are and will be in future, is essential. Confusion creates disillusionment and distrust of the entire system. Uncertainty should not prevail in so important an arena as retirement savings.
- Simplicity and harmonization across the different types of retirement funds is important to enhance understanding and buy-in of members and other stakeholders.

We refer to the tables from Treasury's slide from the 30 October meeting:

	Option 1				Option 2A			
	Annuitise	Deduction	Vested rights	Transfers (pens to prov)	Annuitise	Deduction	Vested rights	Transfers (pens to prov)
2016/17	YES	27.5%	Age > 55	YES	NO	27.5%	NO	NO
2017/18					YES	27.5%	Age > 55	YES
2018/19								

	Option 2B (draft legislation)				Option 2C			
	Annuitise	Deduction	Vested rights	Transfers (pens to prov)	Annuitise	Deduction	Vested rights	Transfers (pens to prov)
2016/17	NO	27.5%	NO	NO	NO	27.5%	NO	NO
2017/18	NO	10%	For transfers	NO	NO	10%	For transfers	NO
2018/19	YES	27.5%	Age > 55	YES	NO	10%	For transfers	NO

OPTION 1 - strongly supported

ASISA members' understanding is that the only additional changes required to their systems and business processes to those that are currently being developed to comply with the 2013 TLAB, and which changes will be effective from 1 March 2016, will be:

- De minimus threshold to be increased to R247 500.
- Communication of change to employers, staff, advisors, consultants, fund trustees and fund members.

ASISA members strongly support Option 1. Given the time available to make and to communicate any changes, it is seen as the correct avenue to follow. While members are concerned to see annuitization compromised by the increase in the de minimus amount, the motivation is understood and at least the compulsory annuitization of provident fund retirement benefits will

commence. The fact that the same de minimus is to apply across all retirement fund types is supported. This consistency supports the principles of simplification and harmonization.

The introduction of a R30 000 minimum deduction, as contemplated in (kA)(i)(aa), if it is also contemplated for Option 1, while supported in principle, is not supported for tax year 2016/2017. It is too late to specify, build and test systems, and the majority of payroll administrators will not be able to make the change timeously.

OPTION 2A - not supported, but if Option 1 is not favourably received by government and Option 2 is selected, then Option 2A is the version that is most desirable.

ASISA members' understanding is that for the tax year 2016/2017, the only additional changes required to their systems and business processes to those that are currently being developed to comply with the 2013 TLAB, which changes will be effective from 1 March 2016, will be:

- De minimus threshold to be R247 500.
- Annuitization of provident fund retirement benefits in excess of the threshold must be "unbuilt".
- Provision for vested rights to be ring-fenced must be "unbuilt".
- Communication to employers, staff, advisors, consultants, fund trustees and fund members.
- The introduction of a R30 000 minimum deduction, as contemplated in (kA)(i)(aa), while supported in principle, is not supported for tax year 2016/2017. It is too late to specify, build and test systems, and the majority of payroll administrators will not be able to make the change timeously.

With effect from the 2017/2018 tax year:

- Annuitization and ring-fencing of vested benefits must be re-instated.
- The R30 000 minimum deduction must be built into payrolls.
- Communication to employers, staff, advisors, consultants, fund trustees and fund members, reminding them of the compulsory annuitization of non-vested retirement benefits of those members under the age of 55.

Option 2A, while not ASISA members' first choice, has the advantage of certainty and systems changes, communication and training will not completely go to waste. It will also have the advantage of allowing additional testing of systems and socialising of the changes with provident fund members. Annuitization while being delayed for a year, will ultimately commence with effect from 2017.

Risk: Treasury suggested at the meeting of 30 October that there is a risk that some Labour constituencies will demand at a late stage that the 2017 annuitization be amended. This is a risk that ASISA members trust can be managed by Treasury so that a repeat of the current uncertainty will not be experienced.

Equal treatment of all retirement fund members as envisaged in Option1 and Option 2A, maintains the spirit of the ultimate aim of retirement reform and paves the way for the merging of pension and provident funds in the long run. This will enhance opportunities for economies of scale to the benefit of members.

OPTION 2B - strongly opposed

This is the most undesirable of all options. The changes and communications that will have to be facilitated for year 2016/2017 will scarcely have been achieved before they need to be undone and the new deductibility limits implemented and communicated. Then for tax year 2018/2019, yet more changes to deductibility limits must be built and communicated, coupled with annuitization. Reducing deductible limits in 2017/18 may well lead to a corresponding reduction in provident fund contributions in order to avoid fringe benefits tax. These contributions may not necessarily be increased again by members in the 2018/19 tax years, leading to an unintended drop in retirement savings.

These annual changes will be an extremely undesirable waste of resources, and will undoubtedly result in confusion and distrust of the system amongst fund members.

Risk: Labour unrest and resignations to access monies from funds that are no longer trusted.

OPTION 2C - not supported

This option will lead to uncertainty and will also bring about confusion and unhappiness amongst fund members. Having enjoyed the benefit of the 27.5% tax deductions for one year, provident fund members will then find a large proportion of that deductibility disallowed. The inevitable outcome will be a split between higher-earning fund members who will opt for the higher tax deduction coupled with annuitization, while lower-earners will reduce their contributions to below the 10% maximum in order to continue to take lump sums on retirement.

It should not be assumed that a reduction in the deductibility of provident fund contributions to 10% will automatically lead provident funds to opt for annuitization. The composition of membership within each provident fund is diverse and consensus to annuitize may not easily be reached. It is more likely that the existing provident structure would remain, no annuitization take place and the members would reduce their contributions in order to avoid fringe benefits tax.

This outcome of reduced contributions coupled with no annuitization goes completely against the long-term interests of these fund members, and is not consistent with what Treasury is seeking to achieve through retirement fund reforms. It undermines the need for consolidation of funds, driving those members who wish to benefit from the higher deductions out of provident funds into separate pension funds, with the lower paid workers remaining in the provident funds.

Risk: With effect from the 2017/2018 tax year, provident fund members who were up until then enjoying tax deductible contributions of over 10% will find their take-home pay reduced because of the fringe benefit taxation of the amount exceeding 10%. These fund members could well take exception to this outcome, and strikes and disruption of business operations could be a very real consequence.

DRAFTING ISSUES IN THE TLAB

ASISA members appreciate that the amendments to the TLAB in respect of provident funds have been drafted in haste. In the annexure to this letter, we point out the errors and omissions that have occurred, and request that they be corrected to avoid unintended consequences and tax legislation that cannot be complied with.

Yours sincerely



Senior Policy Advisor

cc: Ismail Momoniat; Christopher Axelson

ANNEXURE: TECHNICAL DRAFTING ISSUES

1. Paragraph 11(k) and (kA) **duplicate** wording relating to the R350 000 in (aa) and again in (B) where it states “but not exceeding R350 000”. It should be deleted in (B). If it is intended to add the minimum of R30 000 immediately (which is strongly opposed) then it should have a (C) which states “subject to a minimum deduction of R30 000.

If it is retained, which we do not support, the structure of section 11(KA) should be aligned with section 11(k).

It should be redrafted as follows:

“(kA) any amount contributed during a year of assessment to a provident fund in terms of the rules of that fund by a person who is a member of that fund: Provided that—

(i) the total deduction to be allowed in terms of this paragraph must not in the year of assessment exceed ~~the higher the lesser~~ of—

(aa) R350 000; or

(bb) 27.5 per cent of the higher of that person’s—

(A) remuneration as defined in paragraph 1 of the Fourth Schedule (other than in respect of any retirement fund lump sum benefit, retirement fund lump sum withdrawal benefit and severance benefit); or

(B) taxable income (other than in respect of any retirement fund lump sum benefit, retirement fund lump sum withdrawal benefit and severance benefit) as determined before allowing any deduction under this paragraph and section 18A,

~~but not exceeding R350 000~~ and

(C) shall be subject to a minimum deduction of R30 000;

Alignment of paragraph (m):

(m) by the substitution in paragraph (kA)(i)(aa) with the following amount [R350 000] R125 000;

2. We note that a R30,000 minimum deductible limit allowing a deduction for members who contribute up to R30,000 irrespective of the 27.5% limit, has only been included under section 11(kA) i.e. only applicable to provident funds. To subject all retirement funds to the 27.5%/R350 000 limits but only allow the R30,000 minimum deductible limit for provident funds will place lower to middle income members of pension funds and retirement annuity at an immediate disadvantage in comparison to provident fund members and is not in line with the overall drive toward harmonization of retirement funds. It is assumed that this is a drafting error. The introduction of the R30,000 minimum deductible limit should therefore also be applied to section 11(k) i.e. pension funds and retirement annuities.

If Option 2A is to be implemented then there should be no difference in the deduction regime that applies to pension fund and retirement annuity fund members and the regime that applies to provident fund members. In this case there would be no necessity to have two sections - s11(k) and s11(kA) - dealing with deductions and they could be conflated into one. If it is agreed that Options 2B and 2C are not to be proceeded with, then the sections introducing the reduced (10%) deduction and maximum (R125 000) need

to be deleted (these are sections 18(1)(l) and (m) of the most recent version of the TLAB).

3. In the definitions of all the types of funds which deal with the vesting (except the definition of Provident fund) it states “is” a member of a provident fund. It should be changed to “was” a member of a provident fund.

4. Definition of Provident fund

There is a significant typographical error in the definition of Provident Fund.

Paragraph b (iv) b(i) and (ii):

(b) in any other case of a person who is a member of a provident fund—

(i) any amount contributed to a provident fund **for a contribution period** prior to **4 March 2018 the date gazetted by the Minister** *(with the implementation date for provident fund annuitisation still uncertain, this should be as gazetted by the Minister);*

(ii) with addition of any other amounts credited to the member’s individual account of the provident fund prior to **1 March 2016 1 March 2018**. *(Same comment as above for all these dates).*

5. Section 159 of the TLAB amends the implementation date of the tax-free transferability provisions of paragraph 6 with effect from 1 March 2018 (same issue as raised above - this date should be as gazetted by the Minister and be aligned with the date when provident fund members will be subject to annuitization on retirement). This is assuming that the provident fund annuitisation would only come into effect on that date. If this is not the case, it should be amended to come into effect from the effective date for annuitization of provident funds.
6. ASISA has previously advised that section 11(k) requires a similar proviso (ff) to section 11(n)(i). Proviso (ff) to section 11(n)(i) allows retirement annuity fund members to claim deductions against income that is not derived from the carrying on of a trade. Many retirement annuity members claim deductions against different types of income, not all of which can be classified as being derived from trade as required in the charging section of section 11. The proviso was inserted to ensure that these members obtain tax relief against all their income. The current wording of section 11(k) would effectively prejudice these retirement annuity fund members and would lead to a decline/reduction in retirement annuity contributions. Failure to include such a section in the proposed section 11(k) will disallow members of retirement annuity funds who can currently claim deductions against their income that is not derived from trade. The inclusion of this proviso would not give retirement annuity fund members any more tax benefits than they receive currently and would certainly ensure that the contribution base is retained.