2023 REVENUE LAWS AMENDMENT BILL (RLAB)

Presentation to the Select Committee on Finance

PRESENTED BY:

National Treasury & SARS

Title: 2023 RLAB

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Overview of the 2023 RLAB legislative process

- Due to constitutional requirements, the tax bills are split into two separate bills, i.e., money bills in terms of section 77 of the Constitution dealing with national taxes, levies, duties and surcharges (i.e. RLAB) and ordinary bills in terms of section 75 of the Constitution, dealing with administration issues i.e. Pension Laws Amendment Bill.
- The National Treasury and SARS published for public comment the revised 2023 Draft RLAB on 9 June 2023.
- NT and SARS briefed SCoF on 29 August 2023.
- NT and SARS engaged stakeholders that submitted comments through workshops that were held on 6-8 September 2023.
- NT and SARS presented a response document to the SCoF on 25 October 2023.
- NT and SARS briefed Select Committee on Finance on 21 November 2023
- The final Bills were tabled by the Minister of Finance during the MTBPS on 1 November 2023.

2023 REVENUE LAWS AMENDMENT BILL:
"TWO POT" RETIREMENT SYSTEM

"Two pots" retirement system: Policy background

- South Africa has different retirement fund vehicles available to individuals, including pension funds, provident funds, retirement annuity funds, pension preservation funds and provident preservation funds.

- Historically, each of these funds had a different tax treatment for contributions, alongside different rules for withdrawals.

- Since 2012, the South African retirement fund regime has been undergoing fundamental reforms

- These reforms include amendments to harmonise the tax treatment of contributions to the different types of funds, measures to increase preservation (both before retirement and at retirement), and reforms to lower charges and improve defaults, governance and market conduct.

- Many of these reforms have been implemented, including:
  - The harmonisation of the tax treatment of contributions to funds, which was implemented with effect from 1 March 2016
  - The preservation of provident funds at retirement through annuitisation, effective from 1 March 2021.

"Two pots" retirement system: Policy background

- There are two primary concerns regarding the current design of the retirement system.

  - The first concern is the lack of preservation before retirement.
    - For pension funds and provident funds, this access is dependent on an employee terminating employment.
    - Individuals can then access their funds, in full, when changing or leaving a job.

  - The second concern is the lack of access even in cases of emergency by some households that are in financial distress that have assets within their retirement funds.

- In an attempt to address the above-mentioned concerns, Government therefore proposes a further reform to the retirement saving regime.
  - This reform will see the introduction of the so called "two-pots" retirement system.
  - The "two-pots" system seeks to retain the current principle of exempting contributions and growth thereon while taxing withdrawals of benefits (i.e. the EET system).
  - The EET system is retained as a means of, *inter alia*, ensuring that income is only taxed once, retaining the logic applied in the 2016 retirement reform which served to harmonise the tax treatment across various retirement funds, and minimising the complexity that comes with valuing growth on contributions.

Two pots retirement system: Policy background

- Members of retirement funds are allowed a deduction for amounts contributed (be it by themselves or their employer on their behalf) to retirement funds.
- The deduction applicable under the current retirement regime will apply under the “two-pots” regime (i.e. a deduction for contributions, limited to the lesser of R350 000 or 27,5% of the higher of taxable income or remuneration).
- Section 37D deductions as contained in the Pension Funds Act, 1956, will be permissible against the “vested component” and “retirement component”.
- Employer contributions made on behalf of employees are be treated as a taxable fringe benefit in the employee’s hands.
- Arrear contributions that relate to a pre-implementation period will be allocated to the respective pre-implementation period and will be subject to the rules applicable under the current retirement regime.
- Arrear contributions that relate to a post-implementation period will be allocated to the respective “savings component” and “retirement component”.

"Two pots" retirement system: Policy background

- It is proposed that the regime makes provision for the creation of seed capital.
- This will make provision for immediate access to the allowable balance in the retirement fund on implementation date of the "two-pots" retirement system.
- Seed capital refers to the starting balance in the "savings component" on 1 March 2025, which should be available to the member of the retirement fund for withdrawal on or after implementation date of the "two-pots" retirement system.
- This starting balance is to be provided in the "savings component" after reallocation from the "vested component".
- In order to limit the adverse impact on liquidity, it is proposed that seed capital should be calculated as the lesser of ten per cent of the "vested component" and R30 000.
- This is intended to not erode the retirement benefit but at the same time enable pre-retirement access to the benefits.

“Two pots” retirement system: Savings component

- In accordance with this new regime, retirement funds will on or after 1 March 2025, be required to create a component known as the “savings component, which will be housed within the current retirement fund.

- Individuals will be required to contribute an amount of one-third of the total individual retirement fund contributions to the “savings component”.
  - The assets in the “savings component” will be available for withdrawal before retirement.
  - The ability to access amounts from the “savings component” will be provided without the member having to cease employment or having to resign or retire from their respective fund.
  - A member will be allowed to make a single withdrawal within a year of assessment.
  - The minimum withdrawal amount is R2 000.

"Two pots" retirement system: Savings component

- In the event that a member resigns from employment and such member has already made use of their single withdrawal during that tax year, an additional withdrawal will be allowed provided the member's gross interest in their "savings component" is less than R2 000.

- The ability to withdraw from the "savings component" will be applicable on a per fund or per contract basis.

- Withdrawals from the "savings component" will be added to the individual's taxable income and will be taxed at their marginal tax rates.

- In the event that a member dies, their beneficiary can opt to receive the benefit in the "savings component" as either a lumpsum or as a transfer to the "retirement component" of their retirement fund and eventually receive an annuity.

“Two pots” retirement system: Retirement component

- Retirement funds will on or after 1 March 2025, be required to create another component known as the “retirement component, which will be housed within the current retirement fund.
- Individuals will be required to contribute an amount of two-thirds of the total individual retirement fund contributions to the “retirement component”.
- The assets in the “retirement component” will be required to be preserved until retirement (i.e. withdrawals from this component can only be accessed by the member upon retirement per the fund rules).
- Once a member has reached retirement age and retires, the “retirement component” is to be paid in the form of an annuity (including a living annuity).
- The current *de-minimis* as relates to the commutation of annuities (currently R165 000) will apply to annuities from this component.
- The ability to commute an annuity will be determined with reference to the member’s interests in their “vested component” and “retirement component”, and will be determined on a per fund basis.

“Two pots” retirement system: Retirement component

- Withdrawals from the “retirement component” are accessible as a lump sum when an individual ceases to be a tax resident of South Africa. The payment of the said lump sums is however subject to the 3-year rule that under the current regime applies to members of a retirement annuity fund, pension preservation fund or provident preservation fund.

“Two pots” retirement system: Vested component

- Retirement funds will on or after 1 March 2025, be required to create another component known as the “vested component”.

- Retirement funds will be required to value a member’s retirement interest on the date immediately prior to the implementation date, which is 1 March 2025, as these amounts will be subject to the current retirement regime (i.e., vested and non-vested rights arising as a result of the annuitisation reform which came into effect from 1 March 2021 will be retained).

“Two pots” retirement system: Vested component

- Once the regime comes into effect, members will no longer be able to make contributions to their “vested component”.
  - This will however not apply to members of a provident fund who were 55 years or older on 1 March 2021.
  - These members have the ability to continue making contributions into their “vested component” and this will apply until they either retire from or leave the fund they were a member of on 1 March 2021.
  - Should they choose to keep contributing to their “vested component” their full contribution will be allocated to the “vested component”.
  - Continued contribution to their “vested component” means they will not be able to contribute to the “savings component” and “retirement component”.
  - Provident fund members who were 55 years and older on 1 March 2021 are however not precluded from participation in the “two-pots” regime, should they elect to participate in the new regime they will no longer be able to continue contributing to their “vested component” (i.e. their contributions will be split between the “savings component” and “retirement component” as is applicable to other retirement fund members).

“Two pots” retirement system: Vested component

- Amounts contained in the “vested component” will be subject to the current retirement regime.
  - This includes, *inter alia*, the ability to make once-off withdrawals from preservation funds, the ability to access pension and provident funds upon resignation, the continued protection of vested rights arising as a result of the annuitisation reform, and the mandatory annuitisation of two-thirds of a members retirement interest with effect from 1 March 2021.

- Withdrawals from the “ “vested component” are accessible as a lump sum when an individual emigrates from South Africa and ceases to be a tax resident.

- The payment of the said lump sums is however subject to the 3-year rule that under the current regime applies to members of a retirement annuity fund, pension preservation fund or provident preservation fund.

“Two pots” retirement system: Defined benefit funds

- It is proposed that provision should be made for the inclusion of defined benefit funds in the “two-pots” retirement regime.

- Since contributions by a member to the defined benefit fund are based on a defined formula, without reference to contributions and investment performance:
    - defined benefit funds will be required to calculate the one-third contributions to the “savings component” with reference to one-third of the member’s pensionable service and
    - the two-thirds contributions to the “retirement component” with reference to two-thirds of the member’s pensionable service with effect from 1 March 2025.

- Seed capital is to be calculated in the same manner as other funds and can be accommodated with a past service adjustment.

“Two pots” retirement system: Legacy retirement annuity funds

- In is proposed that legacy retirement annuity funds be excluded from the provisions of the “two-pot” retirement system, as the inclusion of the legacy retirement annuity fund policies in the “two-pot” retirement system would require a re-design of these historically acquired legacy retirement annuity fund policies.

- It is however important to note that this exemption is not a blanket exemption, and will be applicable to legacy funds with the following features:
  - Pre-universal life policies or conventional policies with or without profits;
  - Universal life policies with life or lumpsum disability cover; and
  - Reversionary bonus or universal life policies as defined or referenced in the insurance legislation.

- To ensure that the exemption as relates to legacy polies applies only to legacy policies entered into before the formulation of the “two-pots” regime, it is proposed that the exemption applies to legacy policies entered into before 1 September 2024.

- The legacy fund must have submitted a signed declaration to the Financial Sector Conduct Authority (FSCA) stating that they meet the above criteria.

- The FSCA may conduct verification that funds meet the exemption criteria.

"Two pots" retirement system: Transferability of funds

- Members will be allowed to make the following intra-fund transfers at any time they wish, these transfers will be treated as tax free transfers:
  - From their "savings component" to their "retirement component"; and
  - From their "vested component" to their "retirement component".

- Inter-fund transfers are only permissible when a member resigns or retires from their respective fund.

- Should a member choose to make an inter-fund transfer all components will need to be transferred to the transferee fund (i.e. the member is not able to transfer only one component while leaving the other components behind).

"Two pots" retirement system: Transferability of funds

- The below inter-fund transfers will be permissible as tax-free transfers (provided that the transfer is a transfer of all relevant components):
  - From the transferor fund's "saving component" to the transferee fund's "saving component";
  - From the transferor fund's "saving component" to the transferee fund's "retirement component";
  - From the transferor fund's "vested component" to the transferee fund's "vested component";
  - From the transferor fund's "vested component" to the transferee fund's "retirement component";
  - From the transferor fund's "retirement component" to the transferee fund's "retirement component";

- The ability to effect both inter and intra fund transfers will be subject to the fund obtaining a tax directive.

CHANGES AFTER PUBLICATION OF DRAFT RLAB

“Two pots” retirement system

- Postponement of the effective date
- Change of the seeding capital from R 25 000 to R 30 000
- Provident fund members who were 55 years and older as at 1 March 2021 shall, by default, be excluded from the two-pots regime with the opportunity to opt-in should they choose.
- The proposed definition for legacy retirement annuity funds as contained in the draft legislation was amended to include features unique to a legacy policy, i.e., universal life or pre-universal life construct

THANK YOU