cutting through complexity

RETIREMENT REFORM – AN UPDATE

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Retirement reforms

- Revised contribution incentives for retirement savings
- Valuation of DB contributions
- Provident fund post-retirement annuity alignment
- Exemption for non-deductible retirement contributions
- Retirement fund benefit payouts
- Retirement fund lump-sum tax tables
- Personal insurance policies
- Cross-border retirement saving
- Tax-preferred savings accounts
- Retirement reform: The way forward

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Revised contribution incentives for retirement savings

Source	Contribution type – base	% cap	Monetary cap	Retirement fund
Employer taxpayer	Employer contribution = fringe benefit = deemed employee contribution	Unlimited	Unlimited	All retirement funds
All individual taxpayers	The greater of remuneration or taxable income (excl. lump sum income). Rollover of non-deductible contributions & any amount that remains are not taxable upon exit. Contributions include amounts paid towards risk benefits & administration costs.	27.5%	Maximum of R350 000	All retirement funds

- **Changes announced in 2013, effective from 1 March 2015.**

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Valuation of DB contributions

- **The basis of the design is a defined contribution fund which is by far the most prolific in SA. In a DC scheme, the employer contribution is equal to the fringe benefit that the employee enjoy.**

- **With a defined benefit fund (DB), the value is harder to calculate due to an inherent element of cross-subsidisation across members. In short, the value of actual contributions often does not match up with a member's benefits.**

- **The formula used to estimate the contribution amount for DB plans was legislated in 2013. The methodology for calculating the formula was published for comment in the form of a draft regulation on 10 June 2014. Written comment to be received by 23 June 2014.**

- **The comments should address the determination of the 'fund member category' as well as the information to be contained in the 'contribution certificates'. Practical implementation? Funds, administrators, employers and payrolls to comment.**

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Valuation of DB contributions

- The design for determining a value for contributions to a fund with a DB or underpin component, is based on a prescribed methodology.
- The prescribed methodology is used to determine a notional employer contribution for members of that fund.
- The notional employer contribution will be treated the same as a DC fund contribution, i.e. a fringe benefit, eligible for a deduction up to the allowable annual and monthly deductible limits.

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Valuation of DB contributions

- **The taxable fringe benefit for a fund with a DB or underpin component, must be determined in accordance with the formula:**

X = (A x B) - C

'X' = fringe benefit

'A' = employee's fund member category factor (provided as per contribution certificate)

'B' = amount of employee's retirement funding employment income (calculated as per the fund rules with reference to actual remuneration)

'C' = employee's actual fund contribution in terms of the rules of the fund,

in respect of that year of assessment.

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Valuation of DB contributions

- The methodology is based on the concept of a ‘fund member category’.
- A ‘fund member category’ = a group of fund members (1) whose entitlement to receive benefits and the value of those benefits are determined by the same rules, and (2) where the same contributions are paid as a proportion of pensionable salary by the group of fund members and their employer.
- The fringe benefit should be calculated separately for each fund member category of a fund.
- This is to ensure that the fringe benefits are calculated across groups of members in the same way as the fund pools contributions and the costs of paying benefits across members.

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Valuation of DB contributions

- The fund would be required to calculate the ’fund member category factor’ by following the calculation method specified in the regulations.
- This requires the fund to separate benefits for which members of the fund are eligible into defined benefit, defined contribution, underpin and risk benefit components.
- A separate calculation method is specified for each type of component.
- If the fund offers more than one benefit component of a particular type, a calculation would need to be performed for each benefit component separately, and the results aggregated.

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Provident fund post-retirement annuity alignment

- As from 1 March 2015 provident fund members will be required to annuitise upon retirement.

- However, the vested rights of existing members are protected–
  - above 55 years (remaining in that fund) by not requiring them to annuitise any retirement savings in that provident fund; and
  - by not requiring annuitisation in respect of any accumulated savings as at 1 March 2015 & any growth thereon (irrespective of whether member remains in the fund).

- The *de minimus* requirement has been raised to R150 000 (now R75 000).

- The phasing out of the <u>means-test</u> for the old age grant is proposed for 2016.

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Exemption for non-deductible retirement contributions

- Non-deductible contributions will be exempt from income tax in respect of retirement interests, regardless of whether these interests are withdrawn as part of a lump sum or by way of compulsory annuity.

- The exemption will not be available to subsequent holders of the annuity.

- As a default rule, the proposed exemption will apply on a "first come, first serve" basis.

- Lastly, the exemption will apply regardless of whether the entire retirement interest or only two-thirds thereof was used to purchase the annuity.

- Effective as from 1 March 2014.

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Retirement fund benefit payouts

- The policy approach for the timing of accrual of retirement fund benefits will be reviewed to provide certainty and ease practical application.

- The accrual of retirement benefits in the case of retirement, death and withdrawal is often separated from the date of payout, leading to anomalies for both taxpayers (employer and employee).

- Clarity must be provided in respect of when monies remain ‘fund money’ (with resultant fund growth), or become a fund benefit with resultant interest growth.

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Retirement fund lump-sum tax tables

- **Lump-sum benefits are taxed according to two tables – pre-retirement withdrawals (mainly following resignations) and at retirement. The former has not been adjusted since its introduction in 2007, while the latter was adjusted once, in 2011.**

- **The proposed amendments to these tables are to be effective from 1 March 2014. The taxable income brackets were increased by about 10 per cent.**

- **There is a larger increase in the bottom bracket for the retirement lump sum table to avoid instances where lower-income workers may be required to pay tax on their lump-sum, even though they did not benefit from a deduction due to their taxable income falling below the tax-free threshold**

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Retirement fund lump-sum tax tables

Table 4.4 Retirement fund lump sum pre-retirement withdrawal benefits tax adjustments, 2013/14

2013/14		2014/15	
Taxable income (R)	Rates of tax	Taxable income	Rates of tax
R0 - R22 500	0% of taxable income	R0 - R25 000	0% of taxable income
R22 501 - R600 000	18% of taxable income above R22 500	R25 001 - R660 000	18% of taxable income above R25 000
R600 001 - R900 000	R103 950 + 27% of taxable income above R600 000	R660 001 - R990 000	R114 300 + 27% of taxable income above R660 000
R900 000 +	R184 950 + 36% of taxable income above R900 000	R990 000 +	R203 400 + 36% of taxable income above R990 000

Table 4.5 Retirement fund lump sum withdrawal benefits tax adjustments, 2013/14 – 2014/15

2013/14		2014/15	
Taxable income (R)	Rates of tax	Taxable income (R)	Rates of tax
R0 - R315 000	0% of taxable income	R0 - R500 000	0% of taxable income
R315 001 - R630 000	18% of taxable income above R315 000	R500 001 - R700 000	18% of taxable income above R500 000
R630 001 - R945 000	R56 700 + 27% of taxable income above R630 000	R700 001 - R1 050 000	R36 000 + 27% of taxable income above R700 000
R945 000 +	R141 750 + 36% of taxable income above R945 000	R1 050 000 +	R130 500 + 36% of taxable income above R1 050 000

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Personal insurance policies: Sections 10 (gl) & 23(r)

- **Background: The tax treatment of life and disability premiums and policy proceeds that was aligned in 2013 will come into effect from 1 March 2015; the premiums will not be deductible and the policy proceeds will be tax free.**

- **Reasons for change: The wording prohibiting the deduction of the premium for tax purposes does not cover all circumstances, which may allow providers to argue that certain structured products fall outside the ambit of the legislation.**

- **Proposal: The wording should be clarified so that premiums paid in respect of all personal insurance policies of a personal nature will not be allowed as a deduction against income, and that the policy proceeds from such policies are free from tax free.**

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Cross-border retirement saving

- South African residents working abroad and foreign residents working in South Africa regularly contribute to local and foreign pension funds. With overall retirement reform now in effect, cross-border pension issues need to be reconsidered.
- Given the complexity of the issues involved, it is proposed that the review take place over two years during which extensive consultation will take place.
- Certain provisions in the Income Tax Act refer to "pension" or to "pensions or an annuity". The wording excludes lump sum retirement fund benefit pay-outs.
- It is proposed that the provisions be amended to apply equally to annuities and lump sums since the policy that the taxability of retirement fund benefit payouts should not be influenced by the format in which the payment is being made.

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Tax-preferred savings accounts

- **The paper '*Non-retirement savings: tax free savings accounts*' was published on National Treasury's website on 14 March 2014.**

- **The paper provides more details on the non-retirement savings reform announcements made by the Minister of Finance in his 2014 Budget Speech and the Budget Review.**

- **The paper lays the basis for the legislation that will be published for public comment by July 2014, and for tabling and enactment thereafter in the newly-elected Parliament before the end of 2014.**

- **The paper incorporates revisions to the original proposal as per the discussion document titled '*Incentivising non-retirement savings*' based on comments received and from subsequent consultations. It also provides an outline of the administrative requirements and procedures for the accounts.**

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Tax-preferred savings accounts

- Propose to retain the current interest income exemptions, but with no further increased for inflation.
- Individuals will be allowed to open up to two accounts, investing in interest bearing or equity instruments or a combination.
- Total contributions for the tax year may not exceed the annual limit, initially to be R30 000. A lifetime limit of R500 000 will also apply. Taxpayers will be responsible for managing their overall yearly contributions to remain within the prevailing limit (two options).
- Unnecessary withdrawals will be discouraged by not permitting replacement of withdrawn amounts.
- National Treasury and FSB will engage with industry in determining a reasonable early termination charge.

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Tax-preferred savings accounts

- Institutions that have a banking, or collective investment scheme license, as well as government, will automatically be eligible to offer products through the tax free savings accounts, as will stockbrokers registered with the FSB and the JSE, provided that the products offered comply with the stated principles and characteristics.

- The paper outlines a set of principles and characteristics that products should abide by. These include simplicity, transparency and suitability. Therefore, not all market savings or investment products may be appropriate for inclusion in these tax free savings accounts. However, most CISs, bank savings accounts, fixed deposits, retail savings bonds, REITs and insurance investment products that meet the stated principles will be allowed.

- Products with contractual periodic contribution obligations (such as insurance contracts) or excessively high early termination charges are not considered appropriate. Direct share purchases will not be allowed although most exchange traded funds (ETFs) will qualify.

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Retirement reform: The way forward

- The paper '*2014 Budget update on retirement reforms*' was published on National Treasury's website on 14 March 2014.
- The paper (read with the policy paper titled "2013 Retirement reform proposals for further consultation") forms the basis for engaging with key stakeholders directly and/or through NEDLAC, to finalise the legislative framework for retirement reform.
- The paper will also facilitate consultations with ASISA in order to formalise the in-principle agreement to lower costs in the retirement industry. A formal consultation process will be held once each draft legislation, regulation or further technical paper listed is released for public comment.
- The set of draft legislative amendments and regulations will give effect to the policy goals over the next year and beyond. The proposals are consistent with the shift towards a Twin Peaks system of regulating the financial sector.

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Retirement reform: The way forward

The broad policy goals of the intended reforms are:

- Implementing auto-enrolment or a mandatory contribution system: Involves mandation + regulation + adequate provision for low-income and vulnerable workers.
- Improving pre-retirement preservation
- Improving fund disclosure: Prescribed charge disclosure methodology for retirement funds
- Getting the defaults right
- Consolidating funds: To enhance economies of scale for members’ benefits
- Simplifying retirement savings products and making them portable between providers: Simpler, more portable products will increase market competition
- Ensuring effective intermediation: Intermediary remuneration should not create conflicts between their own interests and their duties to clients.
- Providing tougher market conduct regulation and more effective supervision: To protect members and improve market conduct practices.

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Questions

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