

## DRAFT TAXATION LAWS AMENDMENT BILL, 2019

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National Treasury released the 2019 Draft Taxation Laws Amendment Bill ("TLAB") and the 2019 Draft Tax Administration Laws Amendment Bill ("TALAB") for public comment on 21<sup>st</sup> July 2019, with the requirement for comments to be submitted prior to 23<sup>rd</sup> August 2019.

Whilst there are numerous proposed amendments affecting sections of the various tax acts, this note summarises the 4 main amendments affecting retirement funds, namely:

- ❖ A correction to the effective date of tax neutral transfers;
- ❖ Aligning the tax treatment of previously non-deductible contributions to provident funds and provident preservation funds;
- ❖ Aligning the tax treatment of lump sum payments to former members of closed funds; and
- ❖ Reviewing the tax treatment of spouse's pensions.

### ALIGNING THE EFFECTIVE DATE OF TAX NEUTRAL TRANSFERS BETWEEN RETIREMENT FUNDS WITH THE EFFECTIVE DATE OF OTHER MATERIAL RETIREMENT REFORMS

For a number of years, Government has been looking to align the annuitisation requirements of pension and provident funds; that is, to make the purchase of a pension with at least 2/3<sup>rd</sup>s of the members' benefit at retirement a compulsory feature of the structure of retirement fund benefits. The implementation of the requisite legislation has been delayed on a number of occasions, and with each delay, amendments to the Income Tax Act ("ITA") are required in order to ensure that the status quo of benefits and transfers remains unchanged (until the ultimate implementation of the full series of the reforms).

Following the last implementation delay (specifically, the deferral of the harmonisation of annuitisation provisions applicable to pension and provident funds from 1 March 2019 to 1 March 2021, pending further consultation with NEDLAC), a section of the ITA was inadvertently not amended, thus allowing a loophole for tax-free transfers of benefits from pension to provident funds (in practice these transfers should be taxed as withdrawal benefits).

The purpose of the TLAB amendment is to align the effective date of such tax-free transfers with the date of the proposed retirement reforms, under which, the compulsory annuitisation of provident fund benefits will be enforced, i.e. an effective date of 1 March 2021. The amendment will be back dated to 1 March 2019 to ensure that no such tax-free transfers could have taken place.

*Whilst the amendment is necessary to ensure consistency, we remain sceptical of Government's resolve to eventually implement the retirement reforms first introduced into the ITA back in 2013 (with an original effective date of 1 March 2015...).*

#### EXEMPTION RELATING TO ANNUITIES FROM A PROVIDENT OR PROVIDENT PRESERVATION FUND

Contributions to retirement funds that were non-deductible at the time of payment are added to the tax-free portion of the benefit when it is ultimately paid. Specifically, in the case of funds requiring the purchase of annuities at retirement (pension funds, pension preservation funds, retirement annuities), such proportion of the pension or annuity income derived from these non-deductible contributions is then treated as non-taxable income.

In the case of provident and provident preservation funds, the non-deductible contributions can currently only be offset against any lump-sum benefit received (and not a pension or annuity benefit).

With the continuing efforts by Government to align the tax treatment of pension and provident funds, and in conjunction with the drive towards annuitisation with the introduction of the default annuitisation requirements for all funds, an amendment to the ITA is required to ensure that members annuitising their benefits from a provident or provident preservation fund will also enjoy the favourable tax treatment relating to these non-deductible contributions. As such, the TLAB makes provision for tax-deductibility of any non-deductible contributions made to a provident or provident preservation fund in determining the taxable annuity received from such fund on or after 1 March 2020.

*Any incentive for members to annuitise their retirement benefits is welcomed.*

#### TAX TREATMENT OF BULK PAYMENTS TO FORMER MEMBERS OF CLOSED FUNDS

Previous amendments to the ITA exempted the payment of the following lump sum benefits to members (or former members) of active retirement funds (all types) from tax:

- ❖ Amounts accruing to members as a result of "secret profits" arising from income earned by the fund's administrator prior to 2008 on the funds' assets that was not previously disclosed to the fund;
- ❖ "Surplus apportionment" payments arising from amounts allocated in terms of Section 15B of the Pension Funds Act as surplus apportionment benefits;
- ❖ "Unclaimed benefits" arising from allocations in terms of Section 15B of the Pension Funds Act or benefits accruing as a result of "secret profits".

Such previous amendments did not consider the possibility of benefits accruing (particularly the "secret profits") to former members of funds which had already been deregistered, with the resulting implication that the payment of such benefits to members would now be taxable.

*The amendment is to ensure consistent treatment on the taxation of these benefits between active funds and previously deregistered funds.*

## REVIEWING THE TAX TREATMENT OF PENSIONS TO SURVIVING SPOUSES

In the event of a fund's benefit structure providing for the payment of a spouse's pension following the death of the member or pensioner, such spouse's pension is taxable as income in the hands of the spouse. Government has raised a concern that such spouses may also be receiving employment income and as a consequence, may be undertaxed throughout the year on the combined income actually received (each piece of the income is taxed as if it is the only income). The consequence is that the surviving spouse may end up with a tax liability upon assessment and must then find the money at that point to settle such liability, which may be problematic and places an undue burden on the spouse.

Government has proposed that with effect from 1 March 2020, in the event that a spouse has multiple incomes, the tax rebates applicable will not be applied when calculating the tax to be withheld monthly. Should such an approach result in tax being excessively withheld, the spouse will be able to reclaim the excess upon assessment.

Such approach will require the retirement funds paying such spouse's pension benefits to apply for a directive which will advise the fund whether or not to disregard the tax rebates.

*The proposal is significantly less penal than the first mooted proposal of taxing the full spouses benefit at a marginal rate.*

*We note that the problem that National Treasury has sought to resolve also applies in respect of retirees who begin receiving a pension benefit but are still in employment (for example, on a contract basis). The proposed amendment does not extend to such individuals, who may also have an unexpected tax liability as a result of having such dual income.*

## AMENDMENT TO THE DEFINITION OF "PROVIDENT FUND"

The definition of Provident Fund has been amended to include a proviso that fund rules "*may provide for an employee who elects to transfer the withdrawal interest to a pension fund established by the same employer or a pension fund in which that employer participates*"

Our interpretation of the intention of this clause is that, on withdrawal, a member can consolidate his paid-up provident and pension fund benefits into the pension fund of his / her employer (there will be no tax implications on transfer) in order to reduce costs of administering two benefits. This applies in cases where the employer operates a "hybrid" pension / provident fund structure or where the employer participates in a number of different retirement funds (both pension and provident) for its employees.

The explanatory memorandum issued with the TLAB, however, makes reference to the above transfer occurring "*immediately prior to retirement*", which may suggest that the intention is to allow members to transfer their benefits from a provident fund to a pension fund, allowing these members to access the pension fund's default annuity strategy (which may include in-fund pensions) with the total value of their benefit across both funds (if applicable). It is, however, unclear how this will be implemented in practice by retirement funds, but it is likely that amendments to fund rules and to exit practices may be required.

*The additional flexibility offered by the ability to consolidate benefits, particularly into an environment that results in compulsory annuitisation (i.e. a pension fund), can only be a good outcome for members.*

**IF YOU HAVE ANY QUESTIONS OR WOULD LIKE MORE INFORMATION ON HOW THE ABOVE MAY AFFECT YOUR RETIREMENT FUND, PLEASE CONTACT YOUR KEYSTONE CONSULTANT DIRECTLY.**

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