THE MEDIUM-TERM BUDGET POLICY STATEMENT 2021 AND RETIREMENT FUNDS

The Minister of Finance, Mr Enoch Godongwana (the Minister), tabled the Medium-term Budget Policy Statement (MTBPS) in Parliament on 11 November 2021. The Taxation Laws Amendment Bill (TLAB) was released at the same time as the MTBPS.

The MTBPS outlines fiscal developments over a three-year period and points to whether the fiscal path is still in line with that set out in the national budget.

The retirement funds industry was expecting discussion papers to be issued at the same time as the MTBPS about certain aspects of retirement reform, but this did not eventuate.

Further detail on the two-pot system is coming soon

Treasury had previously raised the possibility of a two-pot system for retirement funds. Pot one would be for longer-term retirement savings and would have to be preserved (even if members left employment) and paid out at retirement. Pot two would be for short-term financial needs and members would be able access pot two for this purpose while still employed and members of the fund. Contributions would be split between the pots (in a proportion not yet announced).

In the MTBPS, the Minister stated the following as regards these proposals:

> "On retirement reforms, we are proposing measures to boost household savings by increasing preservation before retirement and to increase flexibility through partial access to retirement funds through a "two-pot" system.
> In terms of this system, individuals would be able to access contributions to the one pot, while contributions to the other pot would be saved until retirement.
> These measures would require legislative changes and further consultation. Limited withdrawals would also depend on affordability and liquidity of funds.
> National Treasury will shortly publish a discussion document on the details of this proposal to obtain inputs before further announcements are made in the 2022 Budget."

Thus, we can expect to see a discussion document soon and thereafter consultations taking place on the proposals contained in this discussion document.

Taxation Laws Amendment Bill 2021

The three main issues related to the TLAB for retirement funds are set out below. Please note that TLAB amendments to the Income Tax Act are not yet effective.

Non-tax residents in South African funds

Draft tax changes were previously proposed for individuals who have ceased to be tax residents in South Africa and are still members of a fund in South Africa. Treasury is concerned that if a member of a fund ceases to be a tax resident and later retires from the fund or dies, the Income Tax Act deems such amounts to be from a South African source, thus remaining within South African tax jurisdiction, despite the member no longer being a South African tax resident. However, the member is already a tax resident of another country and the benefit may be subject to tax in that country and not South Africa as a result of a tax treaty. In terms of the previous proposals, persons would be deemed to have withdrawn from their retirement funds in full on the day before they cease to be SA tax residents which would result in a deemed retirement withdrawal tax. If the member then left their monies in the fund until retirement or death then the tax, plus interest, on the deemed withdrawal, would be deferred until the monies are paid out of the fund or the member retires. When payments are actually received from the fund by the member the payments would then be taxed.

This proposal has fallen through for now and was not contained in the TLAB. Treasury received a lot of comments on the proposal which highlighted that the provision bypasses tax treaties and could potentially result in double taxation for members of retirement funds. Treasury has not given up on the proposal and will look for a way to implement it.

Making annuities on retirement more flexible

When a member retires, they can commute an amount for cash and take the rest as an annuity. Depending on the rules of the fund, that annuity can be (i) provided by the fund, (ii) purchased from an insurer in the name of the fund, or (iii) purchased from an insurer in the name of the member. However, a retiring member cannot currently split their retirement benefit and purchase a combination of these forms of annuity.

Treasury wants to increase flexibility at retirement by allowing members to choose a combination of (i). (ii) or (iii) above. The caveat to this is that the portion of the retirement benefit used to purchase each type of annuity must exceed R165 000. Treasury states that the R165 000 threshold is required to "curb the circumvention of prevailing legislation".

On 26 February 2021 the South African Revenue Service (SARS) withdrew General Note 18 and 18A, which previously disallowed this combination of methods of paying an annuity. In addition, SARS has issued Binding General Ruling 58 (BGR 58)[1], which applies from 26 February 2021. The BGR applies to a retirement fund – ie "pension fund", "pension preservation fund", "provident fund", "provident preservation fund" or "retirement annuity fund".

Up to one-third of the member's total retirement interest (retirement benefit) may be commuted for a single payment and the remainder must be paid in the form of an annuity (including a living annuity). SARS states that these provisions do not prescribe whether the annuity must be provided by the retirement fund or purchased from an insurer, nor do they prescribe the nature or characteristics of the annuity.

[1] A Binding General Ruling (BGR) is issued by SARS on matters of general interest or importance and clarifies the Commissioner's application or interpretation of the tax law relating to these matters. It is issued under section 89 of the Tax Administration Act.

SARS reminds us that it can prescribe what funds rules may provide. SARS has prescribed that the rules of retirement funds may provide for:

- the retirement fund paying the annuity directly;
- purchasing the annuity in the name of the retirement fund;
- purchasing the annuity in the name of a retiring member; and
- any combination of the above methods, provided that multiple annuities of each type may be provided for.

This may lead to funds reconsidering their annuity methodology and rules.

Members of preservation funds who have reached retirement age but not yet opted to retire

The current wording of the Income Tax Act results in a situation where if a member of a pension preservation fund or provident preservation fund, who has reached normal retirement age in terms of the fund rules but has not yet opted to retire from the fund, transfers into a similar fund (preservation fund or retirement annuity fund), this transfer is taxable in the member's hands.

This was not the policy intention, and the TLAB amendment aims to ensure that such transfers can be effected on a tax neutral basis.