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2023 BUDGET SPEECH

The impact on employed South Africans

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Legal update 1/2023

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Increased tax-free lump sums payable from a retirement fund

The tax table for lump sums that become payable on a member’s retirement, retrenchment, and death from a retirement fund, will be increased by 10%. This means that the tax-free amount that will become payable from 1 March 2023 will be increased from R500 000 to R550 000.

The tax table for lump sums that become payable on a member’s withdrawal, ie resignation and dismissal from a retirement fund, will also be increased by 10%. This means that the tax-free amount that will become payable from 1 March 2023 will be increased from the current R25 000 to R27 500.

The new proposed two-pot retirement system which will allow early access to retirement savings

Government’s aim with introducing the two-pot system is to give members access to a portion of their retirement savings pre-retirement, while preserving the rest for their retirement.

Government will issue a second draft Tax Bill that will set out the revised proposals on how the two-pot system will work. The Tax Bill will also include how the proposals must be applied in an equitable manner to defined benefit funds and legacy retirement annuity funds. These are retirement annuity funds where the member has a guaranteed benefit at a determined age like in a defined benefit fund. In most cases these guaranteed benefits were funded by a lump sum contribution and the member is not contributing to them.

The second draft Tax Bill has not been issued, which makes it difficult to say for certain when and how the two-pot system will be implemented. But it **seems** that the first phase of the two-pot retirement system will become effective on 1 March 2024, and this is how it will work:

- Members will be allowed immediate access to a portion of their retirement savings on 1 March 2024. The second draft Tax Bill will include the details on the portion of the retirement savings that can be accessed.

- All funds will have to implement a new retirement pot and savings pot, and each pot can receive retirement contributions and/or transfers. One-third of the member's total contributions must go to the savings pot, and two-thirds to the retirement pot.

- Amounts contributed to the retirement pot cannot be accessed before retirement and at retirement date, the member must use the total amount to buy an annuity.

- Amounts contributed to the savings pot can be accessed without any restrictions, limited to one withdrawal during any 12 months, and a proposed minimum withdrawal amount of R2 000.

- A withdrawal from the savings pot will be added to the member's taxable income in the year of withdrawal. This means it will be taxed at the member's marginal tax rate and not on the withdrawal tax lump sum table. If the member decides to withdraw an amount from the savings pot as a lump sum on retirement, the available balance will be taxed on the retirement lump sum tax table.

- Members who resign from their job will still be able to take their accrued retirement savings amount on 1 March 2024, ie vested benefit, as a lump sum.

As a **second phase** of the implementation of the two-pot system, government will review and issue proposals on whether to allow withdrawals from the retirement pot if a member is retrenched and has no alternative source of income.

Auto-enrolment of retirement fund members

Not all employed South Africans belong to a retirement fund because currently it is not compulsory for employers to provide retirement fund benefits to their employees. The Minister of Finance indicated that during 2023, National Treasury will finalise policy proposals, on how to expand the participation and coverage of all formal and informal workers in a retirement fund, without excessively burdening their disposable income. They will also consider a voluntary and flexible savings scheme for informal workers.

Information technology governance and risk management of financial institutions

There has been a marked increase in cyber-attacks against financial institutions. To mitigate information technology (IT) and cyber risks to companies and consumers, the FSCA and the Prudential Authority issued two joint standards which want to ensure better IT governance and risk management.

The joint standard on Cybersecurity and Cyber Resilience Requirements, sets out the minimum standards for sound practices and processes of cybersecurity and cyber resilience for certain financial institutions, like retirement funds and their administrators. While the joint standard on Information technology risk management, prescribes the requirements that a financial institution must comply with for information technology risk management. The Minister indicated that the FSCA and the Prudential Authority will soon finalise these joint standards.

Financial sector reform

Transformation and financial inclusion

The FSCA published the draft transformation strategy for the financial sector in February 2022. In the first phase of implementation, the FSCA will engage with industry and other stakeholders on the current legal landscape governing transformation. In the second phase, it will set and supervise specific licensing and regulatory requirements for financial institutions in line with the relevant legislation. The FSCA has committed to follow a proportionate approach that will not overly burden small businesses. The Minister indicated that the final strategy will be published by March 2023.

Unclaimed assets

The FSCA issued a discussion document in September 2022 on the different types of unclaimed assets in the financial services industry, including unclaimed retirement benefits, of almost R90 billion. One of the noteworthy proposals made in the document is that a single central unclaimed assets fund should be established. This means that retirement funds will be forced to transfer their unclaimed benefits to this central fund. An alternative proposal is that the unclaimed assets could be transferred into the National Revenue Fund. Further consultation on the FSCA's recommendations will take place in 2023 and the idea is for a final paper to be published in 2024.

Conduct of Financial Institutions Bill (COFI Bill)

National Treasury has revised the COFI Bill based on feedback received from the various stakeholders. The COFI Bill will introduce a new legal framework for the regulation and supervision of the conduct of financial institutions. Several "new" licensing activities will be introduced and although a financial institution will only be granted one license, it can be licensed for more than one activity. It is anticipated that the levy due to the FSCA by a licensed financial institution will be an amount based on the type and number of activities that the licensee provides.

A retirement fund is considered to be a financial institution under the COFI Bill and is bound by its provisions. Retirement fund administrators will also be subject to the requirements of the COFI Bill. Once the COFI Bill is passed, the FundsAtWork Umbrella Funds and Momentum Corporate as their administrator will have to adhere to its provisions.

The COFI Bill will also apply to a participating employer in a retirement fund for the enforcement of the employer's obligations under section 13A of the Pension Funds Act, ie the obligation to pay contributions to the fund. Once the COFI Bill is passed, the FSCA will:

- be empowered to gather information from an employer and conduct supervisory onsite inspections and investigations
- issue conduct standards, guidance notices and interpretation rulings for an employers' section 13 obligations
- issue enforceable undertakings and impose administrative penalties if an employer contravenes section 13A.

The Minister said that the COFI Bill is expected to be tabled in Parliament in early 2023.

Taxation of retirement fund contributions

Employer contributions to a retirement fund are taxed as a fringe benefit in the hands of the member. Member and employer contributions are tax deductible up to 27,5% of the higher of the member's remuneration or taxable income, subject to a maximum of R350 000 per annum.

Clarification that employer retirement fund contributions are deductible

Currently, the employer contribution to a retirement fund is deemed for tax purposes to be a contribution made by the employee. The value of the fringe benefit is equal to the employer contribution. But there is no requirement that the value of the fringe benefit is included in the employee's taxable income. The tax legislation will be clarified so that the value of this fringe benefit is included in an employee's taxable income before a tax deduction is allowed.

For example, if an employer contributes R3 000 on behalf of the member and the member earns R10 000, then the R3 000 should be added to the R10 000, making the member's taxable income R13 000. For calculating the maximum deductible contribution, R13 000 should be used and not R10 000, meaning that the full R3 000 is deductible. If the calculation was done on the R10 000, only R2 750 of the R3 000 contribution would have been deductible.

In our view, the employer contribution is already included in the employee's taxable income but qualifies for a tax deduction at the same time, resulting in a tax-neutral position for the employee. So, it is not clear what needs to be clarified in tax legislation.

Apportioning the tax-deductible retirement fund contributions of a member who is no longer a tax resident

It appears that government intends to limit the tax-deductible retirement fund contributions of a member who is no longer a tax resident during a tax year, in the same way as the limitation on the annual interest exemption for non-tax residents. This means that the qualifying amount for the deduction will be limited to the number of days in that tax year that the member was a tax resident, divided by 365.

In our view this proposal implies, that a member of a South African retirement fund who is no longer a tax resident in any given tax year, will not qualify for the tax deduction on contributions made to that fund, either during the tax year in which the contributions were made, or when the member leaves the fund.

Transfers between retirement funds by members who are 55 years or older

The definition of 'normal retirement age' in the Income Tax Act refers to 'the date on which the member becomes **entitled** to retire'. This means that if a member's employer-stipulated normal retirement age is 65, but they are **entitled** to go on early retirement from age 55, as provided for in the rules of the fund in which their employer participates and they are a member of, their 'normal retirement age' as defined in the Income Tax Act will be 55.

Our current tax laws allow for a tax-free transfer if a member transfers their withdrawal benefit **before** the 'normal retirement age' to a pension fund, pension preservation fund, provident fund, provident preservation fund or retirement annuity fund. A member who is over the early retirement age of 55 and who still contributes to their pension or provident fund, will only be able to do a tax-free transfer to a preservation fund or a retirement annuity fund, and not to a pension or provident fund, because their transfer would constitute a transfer **on or after** the 'normal retirement age' but before their retirement date, ie when they decide to retire from the fund. This could be seen as unfair, especially if, for example the employer decides to transfer from a stand-alone pension or provident fund to another pension or provident fund, such as an umbrella fund or when a section 197 transfer occurs, and the member is subject to an involuntary transfer.

To address this, the proposal is that these members must also be able to do a tax-free transfer to a pension or provident fund. An additional proposal is that the value of the transferred benefit, including any growth, will remain ring-fenced and preserved in the receiving pension or provident fund until the member chooses to retire from that fund. This means that these members will not be entitled to the payment of a withdrawal benefit for the transferred amount.

Although we support the proposal, we are concerned about the additional proposal. If the two-pot retirement system is not implemented, this could be a problem because the member will still be able to take the benefit built up with the contributions in the new pension or provident fund as a withdrawal benefit until they reach the age of 65, but they will not have the same right to the transferred benefit. For example, if the member didn't leave their pension fund, they would have been able to take a withdrawal benefit at any time before age 65.

Medical tax credits

This year, the value of the medical tax credits will be adjusted with inflation:

- From R347 to R364 a month for the person who pays the medical scheme contributions (main member) and their first dependant.
- From R234 to R246 a month for any further dependants.

Reviewing tax provisions for remote working

The Minister confirmed that considering the large number of people working from home over the last three years and as part of exploring the effect of remote work on personal income tax, National Treasury and SARS committed to a multi-year review of the current travel and home office tax allowances. A discussion document will be released in 2023 to outline workplace practices and policies, changes in the current environment and how workplaces are impacted by home office and travel allowance policies.

Third-party data and personal income tax administration reform

The pay-as-you-earn (PAYE) and personal income tax administration reform announced in the 2020 budget gave pensioners the option to agree to more accurate PAYE withholding rates to take account of multiple sources of income, as well as enabling 2,9 million individual taxpayers to be automatically assessed without the need to file personal income tax returns. The tax reform will continue over the medium term to reduce the administrative burden of employers, payroll administrators, SARS, and individual salaried taxpayers. Work has started, in consultation with employers and representative organisations, to provide employer and employee data monthly, in a fully automated way. Over time, the need for employer PAYE annual reconciliation is expected to fall away, and the reform will be extended to third-party data providers.