momentum

Legal update

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Non-retirement savings: tax free savings accounts

A. Introduction

The concept of tax free savings accounts was first proposed by National Treasury in the 2012 Budget Review as part of the non-retirement savings reform. Treasury has indicated that it will go ahead with plans to implement tax exempt savings accounts in 2014 and in a paper published in March 2014, provided an overview of their proposal.

Non-retirement savings reforms together with the reform on the retirement system, already underway, represent National Treasury's efforts to encourage household savings with the broader benefits of reducing excessive debt and reliance on the state.

B. The current position

The current mechanism to incentivise non-retirement household savings is an annual interest tax exemption of R23 800 for individuals below 65 and R34 500 for individuals over 65.

C. The proposed reform

Following comments received on the discussion document 'Incentivising non-retirement savings", National Treasury has revised their original proposal on tax free savings accounts.

1. Key features:

- Individuals will be allowed to open two tax exempt savings accounts per year.
- Each account may have interest or equity products, or both.
- Total contributions to each account is limited to R30 000 per tax year.
- Any amounts withdrawn from the account cannot be replaced.
- Taxpayers will be responsible for ensuring that their contributions do not exceed the annual limit.
- The total lifetime contribution limit will be R500 000. The accumulated savings (contributions plus interest) can exceed R500 000.

2. Who may offer products through tax free savings accounts?

- Institutions with a banking licence.
- Institutions with a collective investment scheme licence.
- Government.
- Stockbrokers registered with the Financial Services Board (FSB) and the Johannesburg Stock Exchange.

National Treasury will develop a framework that makes it attractive for firms to participate in this initiative.

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3. What types of products may be offered?

- Products that are:
  - *simple* and easy to understand,
  - *transparent* with regard to the disclosure of costs, and
  - *suitable* for the "average" person's portfolio.

- Products that permit flexible contributions and do not bind individuals into any future contribution schedules.

- Eligible products that are included:
  - collective investment schemes (CIS,
  - bank savings accounts,
  - fixed deposits,
  - REITs[1],
  - retail savings bonds,
  - insurance investment products that meet the above requirements,
  - exchange traded funds (ETFs) that are registered as CIS, and
  - investing in ETF's or similar pooled investments through a stockbroker.

- Products that are excluded:
  - Products that require –
    - fixed monthly deposits or premiums;
    - penalties for the non-payment of premiums, or
    - early termination charges that decrease the pay-out of the investment below the market value of the underlying assets at the time of withdrawal,
  - direct share purchases, and
  - insurance products that include death, disability and other risk benefits.

D. Regulating tax free savings account

The FSB will be responsible for monitoring product providers to ensure compliance with the principles and requirements set out in the draft regulations. In extreme cases of market misconduct, the product may be excluded for the purposes of tax free savings accounts.

E. Transfer of funds

To promote competition amongst service providers, National Treasury has proposed that the full balance in a tax free savings account be transferable between service providers without affecting the annual or lifetime limits. With regard to collective investments, the fair market value of the underlying assets will be transferable. In the case of fixed deposits and insurance policies, service providers must transfer the market value of the claim and may charge a reasonable exit penalty.

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[1] "REIT" is defined as follows in the Income Tax Act:

"REIT" means a company—

(a) that is a resident; and

(b) the shares of which are listed—

(i) on an exchange (as defined in section 1 of the Securities Services Act, 2004 (Act No. 36 of 2004), and licensed under section 10 of that Act); and

(ii) as shares in a REIT as defined in the JSE Limited Listings Requirements.

F. Administration of tax free savings accounts

1. Dividends tax

All earnings within the account will be free from tax. No dividends tax will be payable on dividends in the account.

Service providers will have to indicate either to the company or to the withholding agent that the shares in respect of which the dividend has accrued is linked to a tax free savings account and is therefore exempt from tax.

2. Reporting requirements

Service providers offering tax free accounts and individuals investing in these accounts will be required to provide information to SARS in their annual returns. SARS will consolidate the information to ensure that the annual limits have not been exceeded.

The South African Revenue Service (SARS) will also submit a report to National Treasury to enable them to monitor the progress of the non-retirement savings initiative.

Draft amendments to the Income Tax Act, introducing tax free savings accounts, will be published in the 2014 Taxation Laws Amendment Bill.

3. Contributions that exceed the annual limit

While individuals will be responsible for ensuring that their contributions do not exceed the overall annual limit, service providers will also be charged with the duty of checking that annual limits have not been breached.

National Treasury has proposed two possible ways of dealing with “over-contributions”.

Option 1: The contributions in excess of the annual limit together with any growth on that amount will be withdrawn from the account and taxed correctly. This option may create an administrative burden on the service provider who has to reverse the transaction, and on SARS, as they may have to contact service providers to ensure that reversals are done correctly. There is no penalty that could be applied to this type situation that would discourage over-contributions. As an alternative, National Treasury has proposed a penalty charge on contributions exceeding the annual limit.

Option 2: The simpler option would be to apply general tax rules to the amount that is in excess of the annual limit. No withdrawals or reversal will take place. A proportion of the interest, dividends, other receipts and accruals and unrealised capital gains will be taxed at the marginal tax rate for that individual. Applying the general tax rule will mean that the tax paid on the over-contributions would be higher than if the over-contributions were generated outside a tax free savings account.

National Treasury has requested comments on these options.

G. Other reforms to encourage savings

The introduction of tax free savings accounts is the first in a series of proposals from National Treasury that aim to reform the non-retirement retail savings landscape. The RSA retail savings bond is another reform measure intended to simplify and encourage saving. National Treasury intends to explore the possibility of an Islamic retail bond to expand the product offering.

National Treasury is working with the FSB to explore further issues affecting non-retirement savings.

National Treasury has requested that the Ministers of Trade and Industry, Justice and Finance work together to develop a programme to deal with the reckless and exploitative lending practices in the retail lending market.

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