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Legal Update

2 of 2021:

How will the 2021 Budget impact employee benefits and the financial sector?

As your partner on your journey to success, we have compiled a summary of the highlights of Finance Minister Tito Mboweni's Budget Speech, for easy reference.

Financial sector reform

- **Review of the functioning of South Africa's financial sector**
  South Africa participated in the review in 2020, through an assessment programme of the International Monetary Fund and the World Bank. The review, to be finalised by June 2021, has so far shown that South Africa's regulatory framework is operating effectively under the supervision of the Prudential Authority and the Financial Sector Conduct Authority (FSCA). It did however suggest updating regulations on corporate governance and enhancing regulator independence and accountability.

- **Government's draft policy paper on financial inclusion**
  Government published a draft paper, *An Inclusive Financial Sector for All*, in 2020. The aim of the paper is to:
  - Establish a policy framework for financial inclusion;
  - Sketch an approach to implementation; and
  - Provide a basis on which the financial services sector, regulators, policymakers and all other stakeholders will promote and support financial inclusion.

  Government will facilitate workshops in 2021 to discuss the comments received on the draft policy paper before finalising it. Government will also work with the financial sector industry and civil society working groups and forums to develop a financial inclusion strategy, including a monitoring mechanism, to assess the state of financial inclusion and the impact of this policy. Financial inclusion refers to the delivery of financial services, at an affordable cost, to the majority of the population who have been historically excluded from or under-served by the formal financial sector.

- **Financial Sector Code transformation requirements for the financial sector**
  The Code currently only applies voluntarily to the top 100 retirement funds. The Financial Sector Transformation Council established seven subcommittees to review the targets in the Code to strengthen transformation of the financial sector. The subcommittees are developing targets for, among others, retirement funds and ownership, access to financial services, and preferential procurement. In 2021, the subcommittees will finalise the revised targets and they will then be published for public comment.

- **Draft Conduct of Financial Institutions Bill**
  A retirement fund and an employer participating in a retirement fund (for purposes of the employer's contribution obligations under section 13A of the Pension Funds Act) are some of the entities that fall within the scope of the Conduct of Financial Institutions Bill (COFI Bill). The COFI Bill sets requirements for financial institutions to meet and outcomes to deliver. It is a key pillar of Government's legislative reforms aimed at strengthening the regulation of how the financial services industry treats its customers.

  The first draft was published for comments in 2018, and the second draft in 2020 for public consultation. Government is currently engaging stakeholders to discuss and clarify comments received and the Minister indicated that a revised draft will be tabled in Parliament in 2021.

- **Draft Financial Sector Levies Bill**
  Published for comments on 24 February 2021, the aim of the Bill is to regulate levies for the funding (to enable them to carry out their duties) of the Prudential Authority, the FSCA, the Financial Services Tribunal, the Ombud Council, the Pension Funds Adjudicator and the Ombud for Financial Services Providers. The Minister indicated that the intention is to submit the Bill to Parliament for approval in 2021.

Unemployment Insurance Fund

- **Contribution ceiling**
  The ceiling for Unemployment Insurance Fund (UIF) contributions has not been increased in the past four years, despite the benefit ceiling increasing. In these circumstances, continued relief for employees who retain jobs and higher salaries is no longer appropriate. The contribution ceiling will therefore be aligned with the benefit ceiling and will be set at R17 711,58 a month from 1 March 2021.

- **Special COVID-19 social relief of distress grant**
  The special grant and the unemployment benefits under the temporary employment relief scheme under the UIF are extended for an additional three months, until April 2021.

Retirement annuity funds

When the total benefit in a retirement annuity fund is less than the prescribed minimum amount, members may access their benefits, which will be paid as a lump sum taxed according to the withdrawal tax table. The current prescribed minimum amount is R7 000 and it has not been adjusted since 2007/08. Government is proposing that the prescribed minimum be increased from R7 000 to R15 000 from 1 March 2021.

Splitting of annuities

Currently, members may not use their retirement interest to acquire various annuities via more than one method. This means they are only allowed to acquire an in-fund annuity or an out-of-fund annuity from an insurer (in the name of the fund or the member) and not a combination of in-fund and out-of-fund annuities. To increase flexibility for retiring members, Government is proposing that members be allowed to use their retirement interest to acquire annuities via more than one annuity method.

Changes to Regulation 28 to increase infrastructure investments

Regulation 28 of the Pension Funds Act limits the extent to which retirement funds may invest the fund's assets in certain categories of assets. These limitations are also referred to as prudent investment guidelines or requirements or prescribed asset requirements.

The Minister announced that draft amendments to Regulation 28 will be published this week for public comment. This amendment follows numerous comments from Government, industry, and labour to encourage investment in infrastructure, particularly in times of low economic growth. The proposed amendments seek to make it easier for retirement funds to increase investment in infrastructure and improve the measurement of infrastructure investment by the FSCA.

The proposed amendments will refer to infrastructure investment already permitted through various asset classes and will also propose delinking the asset category related to "hedge funds, private equity funds and other assets not referred to in the schedule to Regulation 28". Delinking this asset category will make private equity a separate asset class with a higher investment limit.

Early access to retirement benefits

The Covid-19 pandemic has caused many countries to consider allowing members early access to their retirement savings as an interim relief measure.

In the 2020 Medium Term Budget Policy Statement (MTBPS), the Minister said that there had been several proposals from taxpayers and some NEDLAC social partners to enable limited pre-retirement withdrawals from retirement funds, especially during times of a disaster like the CovidD-19 pandemic. At the time, the Minister indicated that although retirement funds were primarily designed to promote lifecycle savings and to encourage members to save while working to provide an income in retirement, Government had consulted with NEDLAC partners to introduce the necessary legislative amendments in 2021 to allow for limited withdrawals under certain circumstances, but linked to mandatory preservation requirements.

In the report of the Standing and Select Committees on Finance on the 2020 second Revised Fiscal Framework, Government was requested to consider how retirement fund members can leverage their retirement fund assets to improve their personal financial circumstances. The Minister indicated that Government continues to engage with trade unions, regulators, and other stakeholders to discuss how to allow early access to retirement benefits, together with mandatory preservation requirements.

Auto-enrolment of retirement fund members

The Minister said in the 2020 Budget that there would be a renewed focus on auto-enrolment of retirement fund members. In his 2020 MTBPS he said that agreement had been reached at NEDLAC to accelerate the introduction of auto-enrolment into a retirement fund for all employed workers, as well as the establishment of a fund to cater for workers currently excluded from coverage, because their employers have not established their own retirement funds. This was an urgent intervention on the way to the establishment of a comprehensive social security system under consideration at NEDLAC.

In this year's Budget, it was repeated, that the NEDLAC constituencies also agreed to accelerate the introduction of auto-enrolment for all employed workers, and establish a fund to cater for workers currently excluded from pension coverage, as an urgent intervention towards a comprehensive social security system.

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

Currently, members who chose to defer the payment of their retirement benefit ('deferred retirees') may only transfer their retirement benefits in their pension or provident funds to a preservation fund or a retirement annuity fund to access it at a later stage from such fund. It seems that Government is proposing changes to the Income Tax Act to also allow for transfers of deferred retirees to pension and provident funds.

Retirement fund members who end their tax residency

If retirement fund members stop being South African tax residents (and become tax residents of other countries), but keep their benefits in a South African retirement fund and only withdraw from the retirement fund when they die or when they retire, such amounts received from the fund are deemed to be from a South African source. This means the amounts received remain within South African tax jurisdiction even if the member is no longer a South African tax resident.

When a member withdraws from the retirement fund, the retirement fund benefit becomes subject to tax in the other country. This is because of the application of the tax treaty between South Africa and the other country, as the member will be regarded as a tax resident in that other country in terms of the tax treaty.

The provisions of the tax treaty between South Africa and the new resident country result in South Africa forfeiting its taxing rights. To address this anomaly, Government is proposing changing the legislation as follows:

- When the member stops being a South African tax resident, the retirement fund benefit will form part of the assets that are subject to retirement withdrawal tax. Thus, the member will be deemed to have withdrawn from the fund on the day before his or her South African tax residency ends.
- For members who are no longer South African tax residents but leave their benefit in a South African retirement fund and only withdraw from the retirement fund when they die or when they retire, the retirement withdrawal tax (including associated interest) payment will be deferred until payments are received from the retirement fund or as a result of retirement.
- When the member eventually receives payments from the fund, the tax will be calculated based on the prevailing lump-sum tables or in the form of an annuity. A tax credit will be provided for the deemed retirement withdrawal tax as calculated when the member's South African tax residency ends.

Medical tax credits

Medical tax credits were introduced in 2012/13 to replace income tax deductions for medical scheme contributions. The Minister announced that an inflationary adjustment in the value of medical tax credits in 2021/22 will apply to the value of medical tax credits from R319 to R332 per month for the main member and the first dependant, and from R215 to R224 per month for any additional dependants.

Reduction of corporate tax

Government recognises that although corporate income tax is paid by business, three parties ultimately bear the burden of this tax – the owners of capital, labour (through wages) and consumers (through prices). Therefore by implication, reducing the corporate tax rate can have a positive effect on wages and employment, while promoting additional investment and, as said in the 2020 Budget, South Africa has a relatively high corporate tax rate compared to similar countries and trading partners.

The Minister announced the lowering of the corporate income tax rate from 28% to 27% for companies with years of assessment starting on or after 1 April 2022. This will be done alongside a broadening of the corporate income tax base by limiting interest deductions and assessed losses. Government indicated that they will consider further rate decreases to make South Africa's tax system more attractive (to assist with South Africa's trade, economic reform and competitiveness) and that this will be done in a revenue-neutral manner.

Penalties for non-submission of six-monthly employee tax returns by employers

Currently, the South African Revenue Service (SARS) can impose a penalty for the non-submission of the six-monthly employees' tax returns by employers. The penalty is calculated as a percentage of employees' tax for the period covered by the return. Where the employees' tax for the period is not known to SARS, due to the non-submission of monthly or six-monthly returns, the penalty can only be imposed retrospectively.

The Minister said that this undermines the purpose and deterrent effect of the non-compliance penalty. It is therefore proposed that SARS be enabled to raise the penalty on an alternative basis in such cases, for example through an estimate of the employees' tax with an adjustment once the actual employees' tax is known.

Review of tax provisions for travel and working from home

Considering the large-scale migration to working at home over the past year, Government will review current travel and home office allowances to investigate their efficacy, equity in application, simplicity of use, certainty for taxpayers and compatibility with environmental objectives. Government recognises the potential effect this review could have on salary structuring and is proposing a multi-year project, starting with consultations during 2021/22.

Long-service awards

An employer is permitted to grant a long-service award (in the form of an asset or a non-cash benefit) to an employee as a no-value fringe benefit, provided that the value does not exceed R5 000, meaning an asset awarded to an employee as a long-service award will not be subject to tax to the extent that the value thereof is R5 000 or less. Currently, employers grant long-service awards in various forms that could be considered non-cash benefits. To ensure similar tax treatment, the Minister proposed that a broader range of other non-cash awards that are similar in value to the R5 000 awards be considered as long-service awards.

Employment tax incentive

The employment tax incentive (ETI) is aimed at reducing the cost of appointing employees between the ages of 18 and 29 years for employers. It allows employers to reduce their pay-as-you-earn (PAYE) tax payments for the first two years in which they employ qualifying employees with a monthly remuneration of less than R6 500, subject to certain limitations.

Some taxpayers have devised certain schemes using training institutions to claim the ETI for students, which is considered an abuse. To counter this, Government is proposing that the definition of an "employee" be changed in the Employment Tax Incentive Act to specify that work must be performed in terms of an employment contract that adheres to record-keeping provisions in accordance with the Basic Conditions of Employment Act. These amendments will take effect on 1 March 2021.

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