Sanlam

Legal Report October 2017

Insurance | Financial Planning | Retirement | Investments | Wealth

Newsletter of Sanlam Employee Benefits: Legal

1. Taxation Laws Amendment Bill, 2017

The Bill was published during October 2017. The main provisions affecting retirement funds are the following:

1.1 Postponement of annuitisation requirement for provident funds to 1 March 2019

In 2015, amendments were made to the Income Tax Act to the effect that provident funds will be treated like pension and retirement annuity funds and will be required to annuitise retirement benefits. This implies that on retirement, members of a provident fund will be permitted to take up to one-third of the retirement benefit as a lump sum and must annuitise at least two-thirds. However, this will only be applicable in respect of contributions made to a provident fund after the implementation date of the amendments. All contributions made before the implementation date, and growth on those contributions, may still be taken as a lump sum on retirement.

The above-mentioned amendments were supposed to come into effect on 1 March 2016 but were postponed for two years until 1 March 2018 in order to provide sufficient time for the Minister of Finance to consult with interested parties, including National Economic Development and Labour Council (NEDLAC), regarding the annuitisation requirements for provident funds after the publication of the comprehensive policy document on social security.

Since discussions on the comprehensive paper on social security are still underway at NEDLAC, the Bill proposes that the provisions relating to the annuitisation requirements for provident funds be postponed for 1 year from 1 March 2018 to 1 March 2019.

1.2 Transferring retirement benefits after retiring from employment

In 2014, changes were made in the Income Tax Act to allow members to elect when to retire from a fund, and the date on which the lump sum benefit accrued to the member depended on the date on which the member elected to retire and not on the date of retirement from employment. As a result, members of retirement funds were allowed to postpone retirement from the funds by keeping their benefits within their funds after retirement from service.

The explanatory memorandum to the draft Bill stated the following:

"While members may retain benefits within respective funds, they may no longer make contributions to those funds. The members are thus effectively inactive. In the case of employer funds, the employee may also have left the employ of the company and may wish to sever ties with the employer. The employer would also be left with the burden of having to keep in touch with an inactive member and deal with additional administration."

Currently the Income Tax Act does not provide a member who retired from employment the option to elect to transfer his benefit to another fund. In order to address the concerns referred to in the explanatory memorandum, the Bill proposes that with effect from 1 March 2018 members who retired from service will be able to transfer their benefits to a retirement annuity fund.

The Standing Committee on Finance (SCOF), at the request of the retirement fund industry, proposed that the final Bill should also allow for transfers after retirement (from service) to preservation funds in order to provide more choices for retirees. This would have been subject to the condition that such transfers may not be withdrawn in the same manner as other transfers to preservations funds before retirement from the fund. However the final Bill does not make provision for transfers to preservation funds after retirement from service and it seems that the National Treasury had a change of heart. The only transfer to another fund that will be allowed after retirement from service, will be a transfer to a retirement annuity fund. This will apply from 1 March 2018.

1.3 Tax exempt status of pre-March 1998 build-up in public sector funds

The current position is that the tax-free status of pre-March 1998 build-up in public sector funds is retained upon the first transfer from such fund to a private sector fund, but that it is lost upon any subsequent transfer. This results in unfair treatment in respect of the benefits from funds that are merged or consolidated (after the transfer from a public sector to a private sector fund). The Bill proposes that the Act be amended with effect from 1 March 2018 to allow the tax-free status to be retained when one further transfer to another fund is made.

1.4 Removing the 12-month limitation on joining newly established pension or provident funds

The Income Tax Act provides that if an employer establishes a new pension or provident fund, existing employees have up to 12 months to apply to join that fund. An employee who fails to apply to join within the 12 month period is not permitted to join that fund.

In order to encourage employees to contribute towards their retirement, the Bill provides that the current limit of 12 months be removed so that existing employees as at the date of commencement of the employer's participation in the fund are allowed to join the fund at any time, subject to the rules of the fund. The proposed amendment will come into effect on 1 March 2018.

It should be borne in mind that the position remains that membership of the fund throughout the period of employment must be a condition of service for all qualifying employees who enter the service of the employer on or after the commencement of the employer's participation in the fund.

1.5 Deduction in respect of contributions to retirement funds

The deduction for employee contributions to a pension fund was historically included in section 11(k) of the Income Tax Act, while deductions for contributions to a retirement annuity fund were included in section 11(n). As part of the wider retirement reform objectives, the tax deductibility of contributions to retirement funds was harmonised across all retirement funds (i.e. pension funds, provident funds and retirement annuity funds) through a replacement of section 11(k) from 1 March 2016.

According to the explanatory memorandum to the draft Bill, the replacement of section 11(k) has created technical complications, e.g. it can *"create anomalies such as generating an assessed loss from contributions to retirement funds that are above the allowable limit when taxable gains are a part of the higher limit".*

The Bill therefore proposes that a new section 11F be inserted in the Income Tax Act and be deemed to apply with effect from 1 March 2016, effectively replacing section 11(k), and including wording intended to avoid circumstances that can create an assessed loss. The amendment should not affect most members of pension funds and provident funds.

1.6 Disallowing the exemption for a lump sum, pension or annuity from a SA retirement fund or insurer in respect of foreign service

Section 10(1)(gC)(ii) of the Income Tax Act currently exempts from tax any lump sum, pension or annuity received by or accrued to any resident from a source outside the Republic (according to SARS such source should be a foreign retirement fund) as consideration for past employment outside the Republic, other than from any SA pension fund, pension preservation fund, provident fund, provident preservation fund or retirement annuity fund. However the exemption does apply in respect of any amount transferred to such SA fund from a source outside the Republic in respect of the member concerned.

The Bill amends section 10(1)(gC)(ii) by excluding (from the exemption) not only amounts from SA funds, but also any lump sum, pension or annuity received by or accrued to any resident from a SA insurer. However the exemption will also apply in respect of any amount transferred to that SA insurer from a source outside the Republic in respect of the member concerned. This amendment will apply as from 1 March 2018.

The fact that the said amendment is proposed, seems to indicate that the exemption provided by section 10(1)(gC)(ii) still applies to member owned pensions/annuities paid by SA insurers until the end of February 2018. The retirement fund industry has asked SARS to confirm that this is the case.

2. Tax Administration Laws Amendment Bill, 2017

The above-mentioned Bill has also been published during October 2017. It contains the following items of interest to retirement funds:

<u>Exemption from submitting a return in respect of dividends</u>

The Tax Administration Laws Amendment Act, 2016, exempts persons who derive a dividend from a tax free investment from submitting a return in respect of that dividend. Retirement funds are tax exempt savings vehicles, as is the case with tax free investments, and the Bill proposes that the exemption from submitting returns also be extended to retirement funds.

<u>Spreading of tax deduction where annual cap of R350 000 applies</u>

For purposes of calculating income tax, employees are able to deduct contributions (made by the employee and/or employer) to pension, provident and retirement funds from their income in terms of section 11F of the Income Tax Act. The deduction is limited to the lesser of R350 000 or 27,5% of the greater of remuneration or taxable income. Where the annual cap of R350 000 applies, the Bill proposes to spread the deduction for employees' tax purposes on a cumulative basis, i.e. over the tax year.

3. Draft Notice on proposed increase in administrative penalties

In terms of section 37(2) of the Pension Funds Act, the Registrar of Pension Funds may impose an administrative penalty for the failure by a pension fund, administrator or third party to submit to the Registrar or any person within a period specified in terms of this Act (or in a directive or condition imposed by the Registrar in terms of the Act), any scheme, statement, report, return or other document or information required in terms of this Act to be submitted. The current maximum penalty is R1000 for every day during which the failure continues.

Section 37(2) further enables the Registrar to prescribe a different maximum amount that may be imposed as an administrative penalty. According to the explanatory memorandum to a draft Notice that was published for comment, the Registrar considers it necessary to increase the maximum penalty amount as it appears that the current maximum administrative penalty does not have a deterrent effect on entities to encourage future compliance with the requirements of the Act.

In terms of the draft Notice the Registrar proposes that the maximum penalty to be prescribed in terms of section 37(2) be increased from R1 000 to R4 000 for each day that the non-compliance continues.

The intention is that the Notice will come into effect on 1 December 2017. Comments on the draft Notice can be sent to the Registrar before or on 20 November 2017.

4. Appointment of Mr Olano Makhubela as acting Deputy Executive Officer for Retirement Funds

The Minister of Finance has appointed a current member of the FSB Board and the National Treasury, Mr Olano Makhubela, to fill the vacant position of Deputy Executive Officer of Retirement Funds (in an acting capacity). Mr Makhubela will act in this position until the Financial Sector Conduct Authority (FSCA) is operational.

With the Financial Sector Regulation Act now signed into law, Mr Makhubela's appointment is effected to assist the FSB executive team to fully deliver on their mandate during the transitional period. His main responsibilities will be to, among others:

- Ensure that the necessary regulatory framework in respect of retirement funds is in place to serve the FSB's regulatory and supervisory responsibilities;
- Ensure that all registered retirement funds under FSB supervision are compliant with sound corporate governance practices;
- Promote open, transparent and coordinated communications on matters pertinent to retirement funds, with both internal and external stakeholders; and
- Ensure that the retirement funds team at the FSB play a meaningful role in the implementation of South Africa's broader macro-economic policies.

Mr Makhubela has been with the National Treasury for 17 years, and for the last 8 years has been working mainly on FSB related matters. He has served on the FSB Board since 2010.

Retirement funds or other clients requiring more information should not hesitate to contact their consultant.