1. Taxation Laws Amendment Bill, 2020

The Taxation Laws Amendment Bill, 2020 ("the Bill") has been introduced to Parliament. The amendments affecting retirement funds are as set out below. All references to "the Act" are to the Income Tax Act.

Annuitisation of retirement benefits from provident funds and provident preservation funds

[Applicable provisions: The definitions of the various types of retirement funds in section 1 of the Act]

The Bill confirms that the compulsory annuitisation of provident fund and provident preservation fund retirement benefits, also known as T-day, will go ahead on 1 March 2021. From T-day members of provident funds and provident preservation funds will be compelled to annuitise at least two-thirds of their retirement benefits (excluding vested benefits), as is currently the case with pension funds, pension preservation funds and retirement annuity funds.

Should the member retire early or due to ill health, the same rules as with normal retirement would apply, i.e. the early or ill health retirement benefit is subject to compulsory annuitisation, with the exclusion of vested benefits.

Vested benefits, as referred to above, refers to that part of a benefit that is not subject to annuitisation upon retirement, and that can in other words be taken in cash. A member's vested benefit depends on his/her age at 1 March 2021.

If the member is younger than 55 on 1 March 2021, his/her vested benefit is his/her contributions to a provident fund prior to 1 March 2021, plus growth. At least two-thirds of all contributions (plus growth) after 1 March 2021 will have to be annuitised, except if the value thereof does not exceed the commutation threshold of R247 500.

If the member is 55 or older on 1 March 2021, contributions made to a provident fund, or transfers made to a provident preservation fund, on or after 1 March 2021 (and growth thereon) can also be taken in cash, provided that the member remains a member of the provident fund or provident preservation fund of which he/she is a member on 1 March 2021. If the member transfers to another fund after 1 March 2021, all contributions to the provident fund of which he/she was a member on 1 March 2021, plus growth, up to the date of transfer will remain exempted from annuitisation. At least two-thirds of all contributions to the transferee fund (plus growth thereon) will however have to be annuitised, except if the value thereof does not exceed the commutation threshold of R247 500.

If a member's fund value consists of a vested and non-vested portion, any deduction in terms of section 37D of the Pension Funds Act will be recovered proportionately from the vested and non-vested portions.

Withdrawing from a preservation fund or retirement annuity fund upon emigration

[Applicable provisions: The definitions of "Pension Preservation Fund", "Provident Preservation Fund" and "Retirement Annuity Fund" in section 1 of the Act]

Currently the definitions of "pension preservation fund", "provident preservation fund" and "retirement annuity fund" in section 1 of the Act make provision for payment of lump sum benefits when a member of any of these funds withdraws from the fund due to him/her emigrating from South Africa, on condition that such emigration is recognised by the South African Reserve Bank for exchange control purposes.

As stated in the 2020 Budget Review, the government will be modernising the foreign exchange control system, and one of the changes will be the phasing out of the concept of emigration for exchange control purposes. The Bill proposes that the definitions of the aforesaid funds be amended to replace the requirement that the emigration must be recognised by the Reserve Bank for exchange control purposes with a new test. The proposed new test will allow payment of lump sum benefits when a member ceases to be a South African tax resident (as defined in the Act), and such member has remained non-tax resident for at least three consecutive years. The proposed implementation date of these amendments is 1 March 2021.

Postponement: Disregarding tax rebates if pensioner has other source of remuneration

[Applicable provision: Paragraph 2B of the Fourth Schedule to the Act]

Paragraph 2B briefly entails that if a taxpayer receives remuneration from more than one source (including a pension from a retirement fund or insurer), the tax rebates applicable to the taxpayer are not to be taken into account by the retirement fund or insurer when calculating the taxes to be withheld on the pension. Any pay-as-you-earn (PAYE) excessively withheld will be refunded by the South African Revenue Service (SARS) upon assessment.

The Bill proposes that the implementation of paragraph 2B be postponed from 1 March 2021 until 1 March 2022.

Clarifying deductions in respect of contributions to retirement funds

[Applicable provisions: Paragraph 5(1)(a) and 6(1)(b)(i) of the Second Schedule to the Act]

Paragraphs 5(1)(a) and 6(1)(b)(i) of the Second Schedule to the Act make provision for a deduction of retirement fund contributions that did not qualify for a deduction in terms of section 11F of the Act, when calculating the amount of lump sum benefits to be included in the member's gross income. These paragraphs refer to "own contributions", which inadvertently prevents employer contributions to a retirement fund on behalf of employees (made on or after 1 March 2016) from qualifying for a deduction under either paragraph. It is proposed that the Act be amended to remove this anomaly, by replacing the reference to "a person's own contributions" with a reference to "any contributions". The effective date of the proposed amendments is 1 March 2016, which aligns with the effective date of section 11F.

Deduction of previously non-deductible contributions from qualifying annuities

[Applicable provision: Section 10C of the Act]

Previously non-deductible retirement fund contributions, which were also not used as a deduction against retirement fund lump sums, can be deducted from a “qualifying annuity”, which is a compulsory annuity paid upon retirement.

“Qualifying annuity” with regard to a provident fund and provident preservation fund is currently defined as “the amount of the retirement interest of a person payable in the form of an annuity (including a living annuity) by a provident fund or provident preservation fund”. This is accordingly limited to a pension paid directly by a provident fund and provident preservation fund, and does not include a pension purchased from an insurer. This has been corrected by defining “qualifying annuity” in the case of a provident fund and provident preservation fund as “an annuity (including a living annuity) as contemplated in paragraph (b)(iv) of the proviso to the definition of ‘provident fund’” and “an annuity (including a living annuity) as contemplated in paragraph (e) of the definition of ‘provident preservation fund’”. “Qualifying annuity” with regard to a provident fund and provident preservation fund will therefore now include a pension purchased from an insurer. Section 10C further currently only refers to “own contributions”, which inadvertently prevents employer contributions to a retirement fund on behalf of employees (made on or after 1 March 2016) from qualifying for a deduction in terms of section 10C. It is proposed that section 10C be amended to remove this anomaly, by replacing the reference to “own contributions” with “any contributions”.

The above amendments will apply from 1 March 2021.

Living annuity paid to a trust

[Applicable provisions: The definition of “living annuity” in section 1 of the Act and a new paragraph 3B of the Second Schedule to the Act]

A new paragraph (eA) is added to the definition of “living annuity” to allow for a lump sum payment to a trust when a trust in receipt of a living annuity is in the process of being terminated. This means that the lump sum will be taxed on the retirement fund tax table for retirement and death. A new paragraph 3B is also added to the Second Schedule, in terms of which the lump sum shall, on the date of payment thereof, be deemed to have accrued to the trust immediately prior to the date of termination of the trust.

The above applies from 1 March 2021.

Previously non-deductible contributions deducted from death benefit: deemed asset for estate duty purposes

[Applicable provisions: Section 3(2)(bA) of the Estate Duty Act and a new section 3(3)(e)]

Section 3(2)(bA) of the Estate Duty Act currently includes as property of the deceased previously non-deductible contributions to a retirement fund that were allowed as a deduction from the deceased’s death benefit. It is proposed that section 3(2)(bA) be deleted, and be replaced by a new section 3(3)(e), the effect of which would be that the aforesaid amount will for estate duty purposes no longer be regarded as property, but as deemed property.

The above will be deemed to have come into operation on 30 October 2019, and will apply in respect of the estate of a person who dies on or after that date, and in respect of contributions made on or after 1 March 2016.

2. Medium-Term Budget Policy Statement

The Minister of Finance delivered the 2020 Medium-Term Budget Policy Statement (MTBPS) on 28 October 2020. An explanatory note on financial sector MTBPS announcements was issued on the same date. The explanatory note provides further details on the financial sector announcements made by the Minister of Finance and states the following regarding retirement reform:

"*Annuitisation Requirement for Provident Funds*

All NEDLAC constituencies have reached agreement for the annuitisation of provident funds to take effect in March 2021, to enable all members to continue to benefit from tax deductions on their contributions. The agreement also includes addressing other anomalies in the retirement industry, to ensure more appropriate and better value-for-money annuity products for low income workers. The emergence of hybrid annuities as an option for the default annuity addresses some of these concerns.

Early Access to Retirement Savings

Retirement funds are designed primarily to promote life-cycle savings, and encourage individuals to save while working to provide an income when they retire. Treasury has received a number of 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 COVID-19 pandemic. Treasury has consulted with NEDLAC partners to introduce the necessary legislative amendments next year to allow for limited withdrawals under certain circumstances, but linked to mandatory preservation requirements.

There is also agreement 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 is an urgent intervention en route to the establishment of a comprehensive social security system under consideration at NEDLAC. Engagements are also underway between Government and social partners to resolve concerns with respect to the governance of umbrella funds. Announcements will be made after completion of further consultations within and outside NEDLAC.

Proposed Review of Regulation 28

Government has initiated a process to review Regulation 28 to make it easier for retirement funds to increase their investment in infrastructure, should their board of directors opt to do so. This proposal follows from a number of comments from government, industry and labour, to encourage investment in infrastructure, particularly in times of low economic growth. A draft gazette will be released shortly for public comment, outlining components of Regulation 28 that are being proposed for review."

3. No change to foreign exposure limits for retirement funds

The explanatory note on financial sector MTBPS announcements also announced that Government would be accelerating certain measures to make it easier to invest in South Africa including, among others, the following:

"*1. **Inward Listing instruments:** All debt, derivatives and exchange traded instruments referencing foreign assets, that are inward listed, traded and settled in Rand on South African exchanges, will be classified as domestic. The classification of all inward listed shares denominated in Rand remains domestic*."

The SA Reserve Bank pursuant to the above issued Exchange Control Circular 15/2020 on 29 October 2020, dealing with the reclassification of inward listed debt and derivative instruments as well as exchange traded funds referencing foreign assets.

However, in Communication 53 of 2020 issued on 13 November 2020, the FSCA informed stakeholders that the inward listing of all instruments on a South African exchange remains extant and that further guidance will be provided from the Financial Sector Conduct Authority. The FSCA also stated the following:

"*Financial Sector Conduct laws that may be affected will be considered and evaluated for impact. Further guidance will be provided from the Authority in this regard and no presumptions pertaining to Financial Sector Conduct laws should be formed on the reclassification*."

However, despite the warning that no presumptions pertaining to Financial Sector Conduct laws should be formed on the said reclassification, some industry players were of the view that the Minister's announcements and the Exchange Control Circular have an impact on the maximum permissible exposure of retirement funds to foreign assets as referred to in Table 1 of regulation 28 of the Pension Funds Act.

In a media release issued by the National Treasury, the South African Reserve Bank and the FSCA on 24 November 2020, they said that the MTBPS announcement aims to create an enabling environment that makes it easier for foreign investors to invest in South Africa. However, "*the announced reforms to the capital flow management framework do not alter the prudential framework currently applicable to all regulated funds, including retirement funds, collective investment schemes and insurance"*. Exchange Control Circular 15/2020 has been suspended with immediate effect "*to reduce the scope for ambiguity related to compliance with the prudential framework for regulated funds*". The dispensation as before Circular 15/2020 therefore remains unchanged.

4. SCA Information Request 5 of 2020 (RF): Request for information related to cancellation of retirement funds

In terms of Information Request 5 of 2020, which was issued during November 2020, the FSCA requested funds and administrators that apply for the cancellation of the registration of a fund which has ceased to exist, to submit to the FSCA, simultaneously with the application for cancellation, a "Report of Factual Findings" by an auditor in accordance with Annexure A to the Information Request.

The said request for information applies to all applications to cancel a retirement fund submitted to the FSCA on or after 1 January 2021. Compliance with the request is compulsory and any failure to do so will constitute an offence. Any application for the cancellation of a fund submitted to the FSCA before 1 January 2021 will however still be considered in accordance with Information Circular PF No. 2 of 2017. The FSCA also noted that the content of the said Circular remains relevant and applicable, and the Information Request should not be construed as a replacement of the Circular.

5. Supreme Court of Appeal declares regulation 35(4) of the Pension Funds Act invalid

Three retirement funds challenged the validity of regulation 35(4) of the Pension Funds Act ("PFA") and, since they were unsuccessful in the Gauteng High Court, appealed to the Supreme Court of Appeal (SCA). On 2 November 2020, the SCA handed down its judgment in the three related appeals of the Southern Sun Group Retirement Fund, the Hortors Pension Fund and the Vrystaatse Munisipale Pensioenfonds.

Regulation 35(4) provides as follows:

"(4) *Where a board is able to determine the enhancement due in respect of a particular former member in terms of section 15B (5) (b) or (c) of the Act, but is unable to trace that former member in order to make payment, the board shall put the corresponding enhancement into a contingency reserve account specific for the purpose. Notwithstanding anything in the rules of the fund, moneys may not be released from such contingency reserve accounts except as a result of payment to such former members or as a result of crediting the Guardians Fund or some other fund established by law to include such amounts*."

The SCA found that the power to deal with a surplus as contemplated in section 15B of the PFA and to establish contingency reserve accounts are within the prerogative of the board of trustees. The SCA therefore ruled that, in promulgating regulation 35(4), the Minister acted beyond the regulation making powers set by the PFA. In the Vrystaatse Munisipale Pensioenfonds case the SCA stated as follows:

"*When a board exercises a discretion in allocating a surplus for the benefit of former members, thereby creating a liability, it must concomitantly decide how to cater for claims that eventuate. The board's decisions can be interrogated by the regulator against the provisions of the PFA, but those decisions are within the remit of the board. Regulation 35(4) intrudes upon the board's wide discretion by compelling the board to place the entire allocation in a contingency reserve account and freezing it in perpetuity*."

The funds' appeals were therefore successful and the SCA declared regulation 35(4) invalid and unenforceable.

It should however be noted that the revised draft of the Conduct of Financial Institutions (CoFI) Bill, which was published during September 2020 for public comment, proposes inserting a new section 37A(5) to the PFA which provides that "Unclaimed benefits may not be reduced or utilised for any other purpose by a fund". It therefore seems that the impact of the SCA judgements may possibly be neutralised should the proposed amendment of the PFA become law.

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