Sanlam

Legal Report August 2022

Newsletter of Sanlam Corporate: Legal

1. Two pot system regarding early access to retirement savings

National Treasury has for some time been consulting with stakeholders on implementing a new retirement fund regime, called the two pot system, in terms of which retirement fund members will have access to a portion of their retirement savings before termination of their fund membership. Draft legislation has now been published in this regard for public comment, with the commentary period having expired on 29 August 2022.

In terms of the draft legislation the two pot system will come into effect on 1 March 2023. It is however unlikely that the system will in fact come into effect on this date as it would leave the retirement fund industry with insufficient time to do the necessary system development. National Treasury is aware of the fact that the 1 March 2023 implementation date is not realistic, and has in a policy discussion document accompanying the draft legislation said the following in this regard:

"*The proposed 2023 implementation date is optimistic, because fund rules need to be changed, there will be systems changes within retirement funds to enable the two-pot system and SARS also needs to create capacity to cater for the new pots and track withdrawals. Furthermore, retirement funds must train employees, educate fund members about the reform and its implication.*"

In terms of the new system three new pots will be created, namely a vested pot, a retirement pot and a savings pot. The vested pot will consist of all contributions up to 28 February 2023, and the current retirement fund regime will remain applicable to this pot. The retirement pot and savings pot will then be accumulated from 1 March 2023. There will accordingly be no seeding finance into either pot.

A maximum of one third of contributions can go to the savings pot, with the remaining amount going to the retirement pot. The one third is a maximum amount, and the member can, depending on the rules of the relevant fund, opt to contribute less than a third, or nothing at all, to the savings pot.

Any contributions above the maximum tax deductible amount, being 27,5% of remuneration up to a maximum of R350 000 per annum, will flow to the retirement pot. Contributions in excess of the allowable deduction will accordingly not be permitted into the savings pot.

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No further contributions can be made to the vested pot, except for members of provident funds who were 55 years or older on 1 March 2021.

As currently, contributions and growth will be exempted from tax, while withdrawals and benefits will be taxed.

Withdrawals from the savings pot will be included in the member's taxable income for that year. The withdrawal tax table will accordingly not apply to withdrawals from the savings pot. The withdrawal tax table will however still apply to withdrawals from the vested pot.

Amounts contributed to the retirement pot cannot be accessed before retirement. At retirement date, the total value in the retirement pot must be paid in the form of an annuity, except if it does not exceed R165 000.

Amounts contributed to the savings pot can be accessed without any conditions, but only one withdrawal can be made during any twelve month period. The minimum withdrawal amount is R2 000, and a member must accordingly have an amount of at least R2 000 in the savings pot before being allowed to make a withdrawal.

It is stated in the Explanatory Memorandum accompanying the draft legislation that a deduction from a member's benefit in respect of pension interest allocated to the non-member spouse, must be deducted from all three pots, in other words from the vested, savings and retirement pots. There is however no provision in the draft legislation that sets out in what proportions deductions in terms of section 37D of the Pension Funds Act must be made from the different pots. The legislation will hopefully be amended to provide clarity in this regard.

Full withdrawals from the retirement, savings and vested pots can take place if a member ceases to be tax resident for a period of at least three years. In these instances, the vested pot will be taxed in accordance with the pre-1 March 2023 tax provisions, the savings pot will be included in the member's gross income and the retirement pot will be taxed in accordance with the lump sum withdrawal tables.

Any funds available in the savings pot at retirement or death can either be withdrawn in full or transferred to the retirement pot. Where the member opts to withdraw funds from the savings pot as a lump sum on retirement, it will be taxable as a retirement lump sum benefit subject to the retirement lump sum table. This means that a member can, depending on whether he/she has received any previous tax-free amounts, receive a tax-free amount of up to R500 000 on retirement.

Members cannot transfer amounts out of the retirement pot but can only transfer to the retirement pot in another fund. Although the intention is that transfers can be made into the retirement pot from any other pot, including from the vested pot, the draft legislation does not currently make provision for a transfer from the

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vested pot to the retirement pot. The legislation will hopefully be amended to clarify that a member can also transfer from the vested pot to the retirement pot. No transfers can be made into the savings pot unless they are from the savings pot in another fund.

It will not be possible to split retirement pots and savings pots between funds. A member can in other words not transfer a savings pot to another fund without also transferring his retirement pot to that fund.

2. Draft Taxation Laws Amendment Bill, 2022

The Draft Taxation Laws Amendment Bill, 2022 (“the Bill”) has been published for public comment. The proposed amendments affecting retirement funds are as follows.

Transfer of total interest in a retirement annuity fund

The current situation is that if a member of a retirement annuity fund wants to transfer to another retirement annuity fund, the member must transfer his/her total interest in the retirement annuity fund. If a member has more than one contract in the fund, he/she can accordingly not choose to only transfer one of his/her contracts. It is proposed that the definition of “retirement annuity fund” in the Income Tax Act be amended so as to allow retirement annuity fund members to transfer only one, or only some, of their contracts in the fund, subject to the following conditions:

- the value of each individual contract being transferred must exceed R495 000;
- in the case where the member is not transferring his/her total interest in the retirement annuity fund, the value of the member’s remaining interest, in other words after the transfer, must exceed R495 000.

The above amendment will come into effect on 1 March 2023.

Protection of vested rights when transferring to a public sector fund

The so-called T-day amendments, which make provision for compulsory annuitisation, came into effect on 1 March 2021. The amendments make provision for the protection of vested rights, in other words benefits that are not subject to annuitisation. Vested rights may also be transferred into another retirement fund without forfeiting their vested rights protection.

It has come to Government’s attention that the current provisions have the effect that vested rights would be forfeited if transfer is made into a public sector fund. To address this anomaly, it is proposed that the definitions of “pension fund” and “provident fund” in the Income Tax Act be amended to ensure that vested rights remain protected upon transfer to a public sector fund.

Although it is stated in the Explanatory Memorandum to the Bill that the above amendment will come into effect on 1 March 2021, the Bill itself provides that the amendment will come into effect on 1 March 2023.

The applicability of T-day to public sector funds

It is stated in the Explanatory Memorandum to the Bill that the T-day amendments (referred to under the previous heading) also apply to public sector pension funds that operate similarly to provident funds. Paragraph (eA) of the definition of “gross income” in the Income Tax Act does however not mention public sector funds that operate similarly to provident funds. As such, there is no clarity with regards to whether or not annuities received from a public sector pension fund that operates similarly to a provident fund should be included in paragraph (eA) of the definition of “gross income”.

To provide clarity, it is proposed that paragraph (eA) of the definition of “gross income” be amended to include annuities from public sector funds that operate similarly to provident funds.

Although it is stated in the Explanatory Memorandum that the T-day amendments also apply to public sector pension funds that operate similarly to provident funds, the South African Revenue Service (SARS) holds a contrary view. SARS is of the opinion that, in terms of the current provisions of the Income Tax Act, the T-day amendments do not apply to such funds. It is not yet known whether the proposed amendment to paragraph (eA) of the definition of “gross income” will cause SARS to change their opinion in this regard.

The proposed amendment will be deemed to have come into effect on 1 March 2021.

Retirement of a provident fund member on grounds other than ill health

Paragraph 4(3) of the Second Schedule to the Income Tax Act currently stipulates that if a member of a provident fund who is younger than 55 retires for reasons other than ill health, any lump sum received shall be taxed as a withdrawal benefit rather than a retirement benefit. This does not apply to members of pension or retirement annuity funds. Paragraph 4(3) will be repealed, with effect from 1 March 2023, so that there is no longer any distinction between provident funds and other retirement funds in this regard.

Tax-neutral transfers from a pension to a provident fund

Before 1 March 2021 transfers from a pension fund to a provident fund or provident preservation fund were taxable. From 1 March 2021, in accordance with paragraph 6(1)(a) of the Second Schedule to the Income Tax Act, such transfers are no longer taxable. Contrary to the intention, such transfers are however only tax-neutral in respect of contributions made to a pension fund after

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1 March 2021. An amendment will be made so that such transfers will also be tax-neutral in respect of contributions to a pension fund before 1 March 2021.

Transfer of in-fund living annuities from one fund to another

In terms of the current definition of “living annuity” in the Income Tax Act it is not clear that an in-fund living annuity would still fall within the definition of “living annuity” if it is transferred to another fund. The definition of “living annuity” will be amended to clarify that an in-fund living annuity cannot only be provided by the fund that the living annuitant was a member of on his/her retirement date. The in-fund living annuity can in other words be transferred to another fund.

Transfer to an unclaimed benefit fund of certain benefits contemplated in section 37C of the Pension Funds Act

Section 37C(1)(c) and section 37C(5) of the Pension Funds Act make provision for the transfer of death benefits to an unclaimed benefit fund in the circumstances therein set out. The definitions of “pension preservation fund” and “provident preservation fund” in the Income Tax Act do however not currently make provision for the receipt of benefits in the aforesaid circumstances. The definitions will be amended, with the aim of enabling such transfers to an unclaimed benefit fund. The wording of the proposed amendments is however not ideal and needs further refinement.

Transfer of benefits from pension preservation fund to provident preservation fund

The definition of “pension preservation fund” is amended to make it possible for a member to transfer from a pension preservation fund to a provident preservation fund.

3. Conduct Standard on the payment of retirement fund contributions

The Financial Sector Conduct Authority (FSCA) has earlier published a draft Conduct Standard on the payment of retirement fund contributions for public consultation. The consultation process has been concluded, and the FSCA accordingly on 19 August 2022 published the final Conduct Standard.

The requirements relating to the payment of retirement fund contributions are currently contained in regulation 33 of the regulations under the Pension Funds Act (“the Act”). The Conduct Standard will replace regulation 33 (with necessary drafting improvements) by providing for the following matters that are currently provided for in regulation 33:

- the minimum information to be furnished to a fund by an employer, with regard to payment of contributions by an employer, in terms of section 13A of the Act;

- notification and reporting obligations on the board of a fund, principal officer or other authorised person, where there is a contravention of, or non-compliance with, section 13A of the Act by an employer; and

- the rate of interest payable on arrear contributions.

  In addition, the Conduct Standard also:

- sets a standard format in which a fund must inform a participating employer of its duties and obligations under section 13A of the Act;

- sets out the format in which a fund must request an employer to notify it of the identity of every director who is regularly involved in the management of the employer's financial affairs;

- prescribes the manner and format of reporting by principal officers of retirement funds, or any other authorised persons as referred to in section 13A(6) of the Act, to the board of a fund regarding compliance with, or non-compliance with, the provisions of section 13A of the Act by an employer;

- imposes standard notification and reporting obligations on the board of a fund where there is a contravention of, or non-compliance with, section 13A of the Act by an employer; and

- sets requirements for a board of a fund, and participating employers, when the board of a fund outsources the collection of outstanding contributions to attorneys.

The Conduct Standard also requires that "*any material contravention of or material failure to comply with sections 13A(2)(b) or 13A(3)(a) of the Act that continues for a period of 90 days, must be reported in sufficient detail by the board to the South African Police Service, in the format determined by the Authority, within 14 days after the expiration of the 90 day period*". In response to comments that the Police is unwilling to open cases related to the non-payment of contributions, the FSCA said the following:

"*We take note of the practical issues raised. However, these practical issues (which can potentially be addressed) should not dictate whether or not the requirement should be inserted. Please also note that the FSCA is currently liaising with the SAPS to see to what extent the process can be improved.*"

The Conduct Standard will come into operation six months after the date of publication, in other words on 19 February 2023, or on a later date determined by the FSCA. In the Statement supporting the Conduct Standard, the following is said in this regard:

"*The implementation date of the Conduct Standard is 6 months after publication, or a later date determined by the Authority. If implementation becomes a*

widespread problem across the industry as a whole because the 6-month period is insufficient, the FSCA would therefore be able to extend the implementation period to a later date.

If implementation in the 6-month period is not a widespread issue, but limited to specific scenarios, these instances will be considered on a case-by-case basis and, if justified, individual dispensations will be granted via exemptions."

4. Proposed directive on customer due diligence measures in respect of the beneficiaries of life insurance policies

The Prudential Authority (PA) has, in terms of the Financial Intelligence Centre Act ("the FIC Act"), issued a proposed directive on customer due diligence (CDD) measures in respect of the beneficiaries of life insurance policies.

In terms of the proposed directive, life insurers must obtain particulars of the beneficiary of life insurance policies, as soon as the beneficiary is identified, designated or amended by the client. A money laundering and terrorist financing risk assessment and commensurate CDD measures must further, in accordance with the FIC Act, be conducted on the beneficiary at the time of the pay-out, but before actual pay-out, of the policy proceeds to the beneficiary.

Life insurers must further, in terms of the proposed directive, include the beneficiary of a life insurance policy as a relevant risk factor in determining the level of risk posed by the policyholder and whether enhanced CDD measures would be applicable to the policyholder as a consequence.

Comments on the proposed directive can be provided to the PA until 8 September 2022.

5. Adjustments to the annual levies payable by financial institutions

The Financial Sector Conduct Authority (FSCA) has published the adjustments to the annual levies payable by financial institutions, including retirement funds and retirement fund administrators, for the levy year 1 April 2022 to 31 March 2023.

The levies which are relevant for the retirement fund industry are as follows:

Levy on retirement funds

(a) The levy in respect of a retirement fund registered in terms of the Pension Funds Act, excluding a retirement annuity fund, pension preservation fund, provident preservation fund and a commercial umbrella fund, is an amount of:

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- R1 424 plus an additional amount of R16.85 per member of such fund and in respect of every other person who receives regular periodic payments from such fund (excluding any member or person whose benefit in the fund remained unclaimed, and beneficiaries of death benefits), or

- R3 263 702,

whichever total amount is the lesser.

(b) The levy in respect of a commercial umbrella fund, pension preservation fund and provident preservation fund is an amount of R1 424 plus an additional amount of R16.85 per member of such fund and in respect of every other person who receives regular periodic payments from such fund (excluding any member or person whose benefit in the fund remained unclaimed, and beneficiaries of death benefits).

(c) The levy in respect of a retirement annuity fund is an amount of R1 424 plus an additional amount equal to 0.0097% of the value of the assets of the fund.

Levy on fund administrators

The levy in respect of an administrator approved in terms of section 13B of the Pension Funds Act is an amount of R9 092 plus an additional amount of R709 per retirement fund under its administration, and an amount of R0.85 per member and in respect of every other person who receives regular periodic payments from such fund, excluding any member or person whose benefit in the fund remained unclaimed, and beneficiaries of death benefits.

Levy for Pension Funds Adjudicator

The levy for the Pension Funds Adjudicator in respect of a retirement fund registered in terms of the Pension Funds Act, including a pension preservation fund, provident preservation fund, a retirement annuity fund and commercial umbrella fund, is an amount of R7.34 per member of such fund and any other person who receives regular periodic payments from such fund, excluding any member or person whose benefit in the fund remained unclaimed.

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

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