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Budget 2022: Far-Reaching Retirement Savings Changes Proposed

Yesterday, during the delivery of the Budget Speech by the Finance Minister of South Africa, mention was made by the Minister regarding continued retirement reform.

Executive Summary

- Treasury is proposing a “two-pot” retirement savings system to allow contributors to retirement funds to have early access to a portion of retirement savings for rainy days.
- The tax impact of the above is being investigated.
- Treasury is aiming to help individuals save for retirement, preserve their jobs and allow for an alternative to short-term savings.

Why is this important?

Retirement saving is recommended to commence when one starts to work. However, the legislation as it stands allows employees to access retirement savings prior to retirement, by resigning from current employment, which leaves the employee without adequate savings for retirement and will ultimately have the impact of putting strain on the coffers of the Government in the future. In addition, a large portion of the population, predominantly in the informal employment sector, have no access to retirement funds at all.

What did the Minister say in the Budget Speech?

“Government has also proposed a fundamental restructuring of the retirement system for individuals to allow for greater preservation and partial access to funds through a “two-pot”

system. Part of this proposal includes the possibility of short-term access, which would be dependent on the approval by trustees of each fund. Consultations are proceeding following the release of a discussion paper last year and the draft legislation on these amendments will be published for comment in the middle of the year." This refers to the Discussion Paper released on 14 December 2021, addressing the problem-statement and proposed restructuring, introducing the so-called "Two-Pot" retirement savings system.

Demystifying the two-pot approach

Since 2012, Treasury has been on a journey to overhaul the legislative framework as relates to retirement savings. Government wants to encourage households to save, but understands that real hardships impact people, leaving taxpayers short on liquid funds for emergencies or "rainy days". Research shows that most South African do not have sufficient accessible savings for these "rainy days". Given the need for taxpayers to access funds quickly in case of emergencies, Government is proposing that taxpayer have pre-retirement access to a portion of their retirement savings.

Where are we now?

Let's recap the retirement savings regime and how to access funds. When an individual is in formal employment, they are typically required to participate in the employer's pension or provident fund. Retirement annuity funds are historically a retirement savings vehicle for persons who are not in standard employment or run their own small business, and those who do not have access to participate in pension or provident funds. One can access retirement savings upon ***retirement*** from the fund. Currently the only way to access retirement funds savings prior to retirement is to resign from employment (or on retrenchment) and to **withdraw** from the retirement fund. Upon **retirement** from a fund or in case of **retrenchment**, special concessionary rates apply (i.e. the first R500 000 of retirement savings is taxed at 0%), whereas when you **resign and withdraw** from a fund, only the first R25 000 is subject to a 0% tax rate. It's a significant difference in post-tax monies received. Even if an individual transfers his/her/their pension fund or provident fund savings to a retirement preservation vehicle on resignation, the taxpayer is allowed a 100% once-off withdrawal at any time before retirement.

What are the proposals?

It is proposed that all retirement funds be restructured to accommodate a "two-pot system". One pot will be accessible at any time (similar to a short-term savings vehicle), subject to limitations, and the second pot will not be accessible at any point until retirement. It is proposed that 1/3rd of any future contributions should go into the accessible retirement fund account and the balance must be preserved until retirement.

Pension preservation and provident preservation funds do not receive contributions – they too will be required to implement a two-pot system for all amounts from the date of implementation.

Any "vested" amounts in a retirement fund (including preservation funds), are proposed to retain their current treatment. This means that preservation funds will need to retain records of whether a once-off withdrawal has been made, and if not, allow that to be made at any point in respect of the vested amounts, as well as maintaining the two-pot system for all amounts post-implementation. Similarly, pension, provident and retirement annuity funds will need to maintain records regarding vested portions and future contributions and related growth portions.

It is proposed that an individual may access his/ her/ their savings in the 1/3rd short-term savings pot only once a year (note that this is a 12-month period and not a tax year nor calendar year). However, if an individual only made a partial withdrawal during the 12-month period, that individual may make a second withdrawal in the same 12-month period, up to the allowable amount. Example from documentation from Treasury: if someone had R100 000 in their one-third pot and they withdrew R70 000 on 1 September, they would be allowed to make a second withdrawal of R30 000 at any point up to 1 September in the following year. This should reduce the desire to take the full value on the first withdrawal but will undoubtedly increase administrative complexity.

What about the tax?

Tax becomes payable when the member of the fund receives a benefit. The withdrawals from the

1/3rd pot should be taxable to ensure fairness but there are many different options available to structure the taxability of both pots at contribution and withdrawal/retirement stage. It will be important not to create an encouragement to withdraw before retirement, by balancing the tax applicable at each point, and not penalising those who require access to the funds so much that they end up with too little on retirement. The paper released by Treasury on 14 December 2021 (just as we were all going off on a well-deserved break), addresses a number of different options for the taxation of retirement funds in light of the two-pot system proposal, and asks for public comment.

It has not been made clear how the current compulsory annuity purchase will apply on retirement if the entire short-term savings pot has been withdrawn on retirement. As it stands today, 2/3rds of the withdrawal on retirement must be utilised to purchase an annuity and only 1/3rd may be withdrawn in cash. If someone has already withdrawn the 1/3rd short-term savings pot when they retire, will their entire retirement savings balance be required to be used to purchase an annuity, or will the 1/3rd to 2/3rd split apply at this point?

Closing thoughts

We appreciate the consideration given by Government to help taxpayers with short-term savings, given real hardships and the dual need for retirement fund preservation. It is however important to strike the balance between the need for access to savings, and the potentially crippling administration which could be forced upon the retirement savings industry and SARS – consultation and solutions-driven interactions will be essential over the coming months. Tax arbitrage should also be discouraged by creating equitable tax treatment of contributions and withdrawals.

The short turnaround time for this, given the implementation plan for 2023 and the desire to introduce compulsory retirement savings (which is not currently in place), will put pressure on all stakeholders – not the least of which will be the need to determine the tax impact of the changes proposed and the administrative support required from the retirement industry. Interesting times lie ahead. We will share our insights as developments are made available.

Should you have any queries in this regard, please contact:

Melissa Duffy
Director (Partner), Global Mobility Services & Employment Tax Advisory
Email:melissa.duffy@kpmg.co.za
M: +27 82 448 1989

Carolyn Chambers
Director (Partner), Global Mobility Services & Employment Tax Advisory
Email:carolyn.chambers@kpmg.co.za
M: +27 83 440 5564

Zohra De Villiers
Director (Partner), Global Mobility Services & Employment Tax Advisory
Email:Zohra.deVilliers@kpmg.co.za
M: +27 82 719 0279