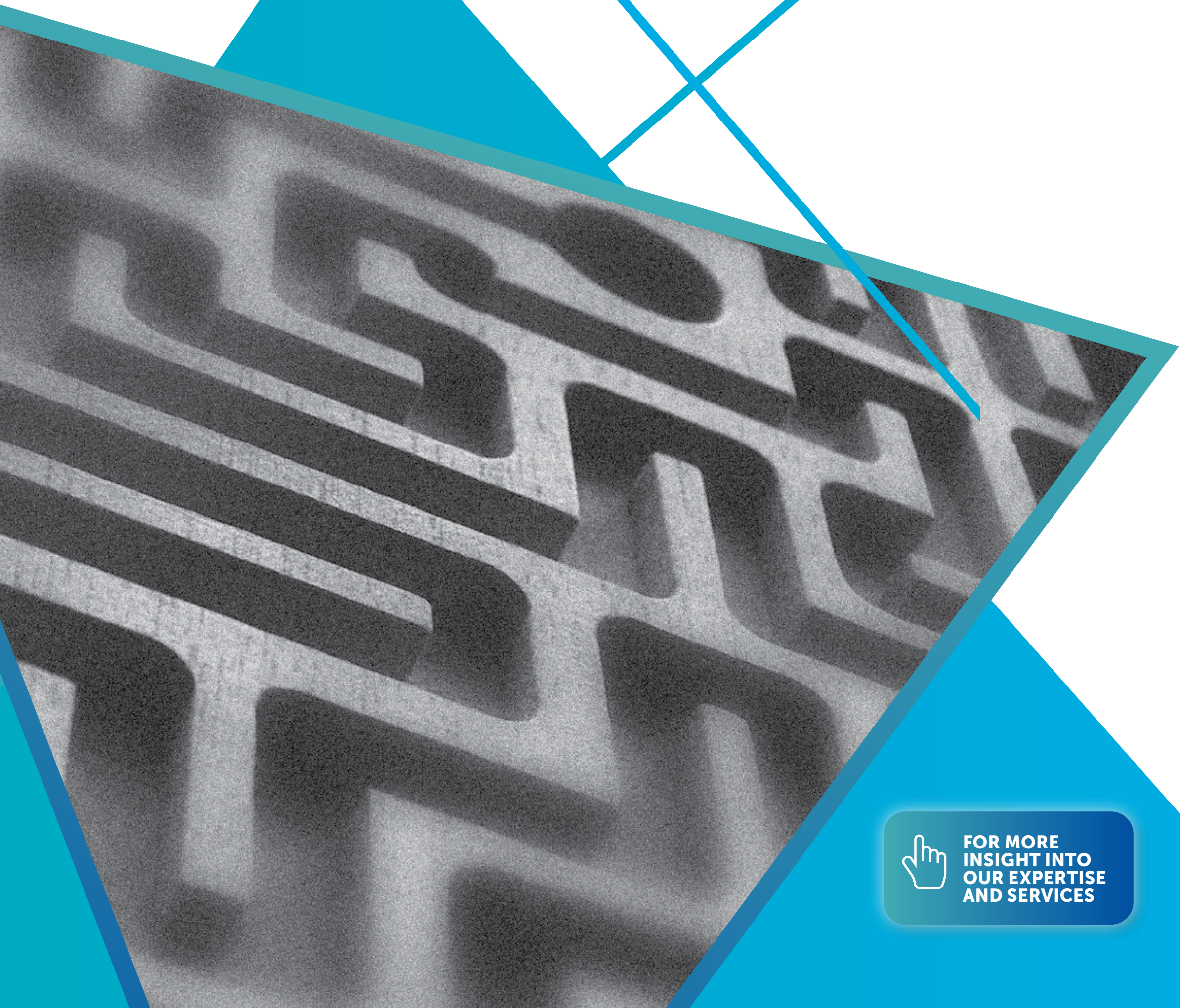
TAX & EXCHANGE CONTROL
ALERT

19 AUGUST 2022



FOR MORE INSIGHT INTO OUR EXPERTISE AND SERVICES

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Article on the two-pot retirement system

In our Tax & Exchange Control Alert of 4 August 2022, we provided an overview of the tax proposals contained in the draft tax amendment bills published at the end of July. One of the proposals relates to the so-called "*two-pot*" retirement system, which we discuss in this article, as contained in the 2022 draft Revenue Laws Amendment Bill (2022 Draft RLAB) and the Draft Explanatory Memorandum on the Revenue Laws Amendment Bill, 2022 (Explanatory Memo).

Article on the two-pot retirement system

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BACKGROUND REGARDING THE PROPOSAL

The Explanatory Memo notes that the different retirement fund vehicles available to individuals, including pension funds, provident funds, retirement annuity funds, pension preservation funds and provident preservation funds, previously had a different tax treatment for contributions and different rules for withdrawals.

Pursuant to the reforms made to the retirement fund regime that commenced some years ago, some proposals to amend the tax provisions dealing with retirement funds have been implemented, such as:

- the harmonisation of the tax treatment of contributions to retirement funds, which was implemented with effect from 1 March 2016; and
- the preservation of retirement funds through annuitisation, effective from 1 March 2021.

However, one of the proposals that has not yet been implemented is pre-retirement preservation.

REASONS FOR THE PROPOSED CHANGE

In the Explanatory Memo, it is explained that there are two primary concerns with the current design of the retirement system, namely:

- The lack of preservation before retirement, which has been highlighted in previous discussion papers.
- The issue that some households in financial distress have assets within their retirement fund(s) that are not accessible even in the case of emergencies. This issue has become more prominent since the COVID-19 pandemic, with numerous calls for financially distressed individuals to be given immediate access to their retirement funds to alleviate financial hardship.

The Explanatory Memo further notes that in December 2021, Government published a discussion document proposing a new retirement fund regime that aims to address both these concerns in the form of a "*two-pot*" system for retirement savings. It entails that individuals can contribute to a "*savings pot*" which is accessible (without any links to changing their employment status), and a "*retirement pot*", which must be preserved until retirement.

PROPOSED TAX TREATMENT

According to the Explanatory Memo, the two-pot system seeks to retain the principle of exempting contributions and growth, while taxing withdrawals and benefits. The tax treatment for withdrawals will be amended, as the value of any withdrawals from the "*savings pot*" and annuity income from the "*retirement pot*" will be included in that year's taxable income. This will therefore require changes to the "*gross income*" definition in section 1(1) of the Income Tax Act 58 of 1962 (Act).

Article on the two-pot retirement system

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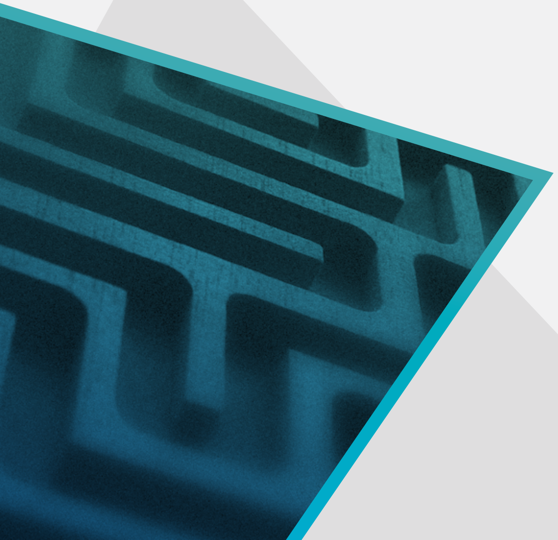
An interesting observation made in the Explanatory Memo pertains to the reasons for deciding to include non-annuitised withdrawals (withdrawals from the "*savings pot*") in taxable income rather than taxation through the respective lump-sum tables. (The lump-sum tables' tax rates are lower than the marginal income tax rates that would apply to taxable income.) The Explanatory Memo suggests that from the public consultation process regarding the discussion document, there was an even support for retaining the *status quo* (retaining the lump-sum tables) and taxing withdrawals at normal rates.

PROPOSED AMENDMENTS TO SUPPORT THE BROADER RETIREMENT REFORM

To enable the implementation of the new "*two-pot*" system, the Explanatory Memo indicates that the following amendments are proposed, amongst others:

- The creation of a new "*retirement pot*" and a "*savings pot*" that can each receive retirement contributions, and which can be housed within the current types of available retirement funds. All contributions before the implementation of the "*two-pot*" system (up to 28 February 2023, based on the proposal) will have to be valued at the date immediately prior to implementation (1 March 2023, based on the proposal), to enable vesting of rights. To give effect to this, the Draft RLAB contains new proposed definitions for "*savings pot*", "*retirement pot*" and "*vesting pot*", that will be included in section 1(1) of the Act.
- On the one hand, a distinction between a "*retirement withdrawal benefit*", relating to withdrawals from the "*retirement pot*" which cannot be accessed before retirement and on the other hand, a "*savings withdrawal benefit*", relating to withdrawals from the "*savings pot*". Amounts contributed to the "*savings pot*" can be accessed without any conditions, but only one withdrawal can be made during any 12-month period and a minimum of R2,000 must be withdrawn if a savings withdrawal is made. The Draft RLAB contains definitions for "*retirement withdrawal benefit*" and "*savings withdrawal benefit*" that will be included in section 1(1) of the Act.
- Permissible withdrawals from the "*vested pot*" will be taxed according to the respective withdrawal tables.
- Regarding contributions, the annual deduction limits contained in section 11F of the Act still apply (the higher of R350,000 or 27,5% of gross remuneration), but a maximum of one-third of the total contribution can go to the "*savings pot*", with the remaining amount going to the "*retirement pot*". No further contributions can be made to the "*vested pot*" from pension funds, provident funds or retirement annuity funds, except for members of provident funds who were 55 years or older on 1 March 2021, as they are able to contribute to those funds until they either leave the fund or retire.



Article on the two-pot retirement system

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- The current provisions for contributions to pension funds, provident funds, pension preservation funds, provident preservation funds and retirement annuity funds will continue to apply for contributions and accumulated interest before the implementation date, together with the associated growth of that total, for each existing member until their retirement.
- In relation to transfers, it is proposed that individuals cannot transfer amounts out of the "*retirement pot*", but can only transfer to another "*retirement pot*" tax free. It is further proposed that no transfers can be made into the "*savings pot*", unless they are from another "*savings pot*" and subject to fund rules. Amendments dealing with the permissible and non-permissible transfers will be outlined in the new paragraph 6B of the Second Schedule to the Act.

It is proposed that the amendments come into effect on 1 March 2023 and will apply in respect of contributions to retirement funds on or after that date.

COMMENT

The proposal, including the proposed amendments giving effect thereto, are relatively complex and, based on their current form, would potentially substantially increase the administrative burden on fund administrators. It is possible that National Treasury will receive a number of submissions on this proposal and it will be interesting to see what feedback is provided during the workshops on the draft bills and submissions that will likely take place after the 29 August submission deadline.

LOUIS BOTHA

2022 RESULTS

CHAMBERS GLOBAL 2018 - 2021 ranked our Tax & Exchange Control practice in Band 1: Tax.

Emil Brincker ranked by **CHAMBERS GLOBAL 2003 - 2022** in Band 1: Tax.

Gerhard Badenhorst was awarded an individual spotlight table ranking in **CHAMBERS GLOBAL 2022** for tax: indirect tax. **CHAMBERS GLOBAL 2009–2021** ranked him in Band 1 for tax: indirect tax.

Mark Linington ranked by **CHAMBERS GLOBAL 2017 - 2022** in Band 1: Tax: Consultants.

Ludwig Smith ranked by **CHAMBERS GLOBAL 2017 - 2022** in Band 3: Tax.

Stephan Spamer ranked by **Chambers Global 2019-2022** in Band 3: Tax.

TOP RANKED
Chambers
Global
2022
Cliffe Dekker Hofmeyr

OUR TEAM

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BBBEE STATUS: LEVEL ONE CONTRIBUTOR

Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

PLEASE NOTE

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