Simeka Consultants & Actuaries

2018 National Budget Review

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in conjunction with the budget team of Sanlam Employee Benefits.

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Finance Minister, Malusi Gigaba's maiden budget speech was keenly anticipated by South Africans wanting clarity on how he proposes to plug the gaping budget deficit. In his own words "This is a tough, but hopeful budget". New tax measures aim to raise an additional R36 billion in 2018/19, mainly through a higher VAT rate and below-inflation adjustments to personal income tax brackets. These measures, along with public spending cuts, will contribute to reducing the budget deficit and funding fee-free higher education and training for poor and working-class students.

The following proposals are relevant to the employee benefits industry:

1. Retirement reform

1.1 Strategies being discussed at Nedlac

Government's retirement reform programme will continue in 2018. Progress on the annuitisation of provident funds and preservation has been slower than anticipated because of a delay in the release of the discussion paper on comprehensive social security reform. As a result, consultations in the National Economic Development and Labour Council (Nedlac) on annuitisation of provident funds and preservation are still in progress and expected to be completed by the end of the year. As soon as an initial agreement is concluded, a set of recommendations can be finalised.

Other issues to be referred to Nedlac include broadening coverage to low-income earners who fall outside the collective bargaining system or work for small employers, and bringing all public retirement funds within the same regulatory framework as private funds.

1.2 Strategies to be implemented by the FSB

Government has also directed the Financial Services Board (FSB) to proceed with the following reforms:

- Lowering costs and consolidating funds: A key driver of costs is the large number of very small and uneconomical retirement funds (there are currently 5 144 funds, of which 1 651 are active). The FSB will oversee a significant reduction in funds (preferably to less than 200);

  Comment: *200 Funds is an aggressive target. Based on data from the FSB's website, this puts the targeted asset threshold at above R1.5 billion per fund.*

- Modernising and improving the governance of all retirement funds to King IV standards: All retirement funds will soon have to submit audited financial statements annually and include a minimum number of independent trustees;

  Comment: *The FSB issued Information Circular 2 of 2018 on the morning of the budget in which one of the proposals is that the audit exemption in respect of small funds be removed.*

  The requirement that funds must have a minimum number of independent trustees is not law at present, other than for umbrella funds.

- Ensuring benefits are claimed: The FSB estimates that, in 2016, over R40 billion in pension and provident fund benefits were not claimed. Working with government, the FSB will consult with Nedlac on more efficient measures to find beneficiaries, including by centralising data and funds.

- Strengthening enforcement measures to deal with criminal and unethical practices: The FSB will publish directives in 2018 to improve disclosures by both retirement funds and administrators, and to outlaw unethical practices.

1.3 Proposed change to legislation

Tax treatment of contributions to retirement funds situated outside South Africa

The Income Tax Act currently exempts all retirement benefits from a foreign source for employment rendered outside of South Africa from taxation. The interaction of this exemption with double taxation agreements and other provisions of the Income Tax Act will be reviewed to ensure that the principle of allowing deductible contributions only in cases where benefits are taxable is upheld.

Align tax treatment of preservation funds upon emigration

Upon formal emigration an individual is able to withdraw the full value of their retirement annuity, after paying the applicable taxes. Government will consider aligning the tax treatment of different types of retirement fund withdrawals in such circumstances.

Comment: *We welcome this proposal, because the industry asked that the concession that currently applies to retirement annuity funds, also be extended to preservation funds.*

Allowing transfers to pension and provident preservation funds after retirement

In 2017, amendments were made to allow the transfer of pension or provident fund amounts to a retirement annuity fund after the retirement of an employee. These amendments expanded the choice of available retirement funds if an individual decided to postpone retirement. Pension preservation and provident preservation funds were excluded as the administration required to disallow once-off withdrawals from these funds was considered too onerous. Industry consultations indicate that the system changes will not be burdensome, thus it is proposed that transfers to pension preservation and provident preservation funds be catered for in the legislation.

Comment: *This is a very welcome proposal that enjoys industry support. Preservation funds will have to put controls into place to ensure that the once-off (pre-retirement) withdrawal option is not available for these members.*

Rectifying tax anomalies on the transfer of retirement funds

The transfer of fund amounts between, or within, retirement funds at the same employer has inadvertently led to a tax liability for members, due to the current wording of the legislation. In principle, there should be no additional tax consequence for members if the transfers refer to amounts that have already been contributed to the retirement fund. Legislative amendments will be retrospectively introduced to correct these unintended tax liabilities.

Increasing the prudential limit

To increase investment in diverse assets, the offshore limit for funds under management by institutional investors is increased by 5 percent for all categories, including the African allowance.

Comment: *We welcome the proposal in principle and await the final details.*

1.4 Implementing Twin Peaks and improving market conduct Regulatory architecture

The minister summarized progress as follows:

Parliament passed legislation enabling the Twin Peaks system of financial regulation in 2017. The two authorities will be established on 1 April 2018, or shortly thereafter. The market conduct authority will only be fully functional after all transitional arrangements are concluded by 2019. In addition, a Conduct of Financial Institutions Bill will be tabled in Parliament in 2018. The responsibilities of the new Financial Sector Conduct Authority include oversight of market conduct in the retail banking sector.

The recommendations based on this review, to be published in 2018, will inform the emerging regulatory requirements. The current ombud system for financial services is fragmented, with overlapping mandates.

As part of the Twin Peaks reforms, this system will be overhauled. A draft policy framework was published in 2017.

1.5 Financial Sector Transformation

To improve monitoring of Transformation in JSE ownership, the National Treasury has introduced an annual ownership monitor. The first edition, published in 2017, notes that net black ownership may be difficult to determine, as shareholders often borrow funds to purchase shares in a company. Retirement funds account for the biggest share of household savings in South Africa, and represent a substantial portion of household wealth. These institutions are the main vehicles through which millions of South Africans save for retirement and other purposes. In 2015, 16.4 million people were members of a retirement fund. The Financial Sector Code should be amended to reflect this reality.

2. Personal income tax

The bottom three personal income tax brackets and the primary, secondary and tertiary rebates will be partially adjusted for inflation through a 3,1% increase. The top four brackets will remain unchanged. The new tax rates, rebates and brackets are indicated below:

Table 4.5 Personal income tax rates and bracket adjustments

	2017/18		2018/19
Taxable income (R)	**Rates of tax**	**Taxable income (R)**	**Rates of tax**
R0 - R189 880	18% of each R1	R0 - R195 850	18% of each R1
R189 881 - R296 540	R34 178 + 26% of the amount above R189 880	R195 851 - R305 850	R35 253 + 26% of the amount above R195 850
R296 541 - R410 460	R61 910 + 31% of the amount above R296 540	R305 851 - R423 300	R63 853 + 31% of the amount above R305 850
R410 461 - R555 600	R97 225 + 36% of the amount above R410 460	R423 301 - R555 600	R100 263 + 36% of the amount above R423 300
R555 601 - R708 310	R149 475 + 39% of the amount above R555 600	R555 601 - R708 310	R147 891 + 39% of the amount above R555 600
R708 311 - R1 500 000	R209 032 + 41% of the amount above R708 310	R708 311 - R1 500 000	R207 448 + 41% of the amount above R708 310
R1 500 001 and above	R533 625 + 45% of the amount above R1 500 000	R1 500 001 and above	R532 041 + 45% of the amount above R1 500 000
Rebates		**Rebates**	
Primary	R13 635	Primary	R14 067
Secondary	R7 479	Secondary	R7 713
Tertiary	R2 493	Tertiary	R2 574
Tax threshold		**Tax threshold**	
Below age 65	R75 750	Below age 65	R78 150
Age 65 and over	R117 300	Age 65 and over	R121 000
Age 75 and over	R131 150	Age 75 and over	R135 300

Source: National Treasury

3. Medical tax credits

The Income Tax Act provides a tax rebate (medical tax credit) for individuals. The medical tax credit consists of two components: medical scheme fees for approved medical scheme contributions and additional medical expenses for out-of-pocket medical payments.

Government is concerned that some taxpayers may be excessively benefiting from this rebate, specifically in instances where multiple taxpayers contribute toward the medical scheme or expenses of another person (for example, adult children jointly contributing to their elderly parent's medical scheme). Where taxpayers carry a share of the medical scheme, contribution or medical cost, it is proposed that the medical tax credit should also be apportioned between the various contributors.

Over the next three years, below-inflation increases in medical tax credits will help government to fund the rollout of national health insurance. Government will increase the medical tax credit from R303 to R310 per month for the first two beneficiaries, and from R204 to R209 per month for the remaining beneficiaries. The medical tax credit will be reviewed after the Davis Committee presents its recommendations.

4. Increase in VAT

A one percentage point increase in VAT to 15% was announced.

Comment: *Government has not adjusted VAT since 1993, and it is low compared to other countries. The current zero-rating of basic food items such as maize meal, brown bread, dried beans and rice will limit the impact on the poorest households.*

5. Social Grants

Government has taken deliberate steps to adjust social grant values above inflation to at least partially cover for the proposed increase in VAT, therefore:

- The old age, disability and care dependency grants will increase on 1 April 2018 from the existing R1 600 by R90 to R1 690 and by a further R10 to R1 700 on 1 October 2018.
- The child support grant will increase from the baseline of R380 to R400 on 1 April 2018 and to R410 on 1 October 2018. This is a 6,6% annual increase.

6. Increasing estate duty

In line with Davis Tax Committee recommendations, and in keeping with the progressive structure of the tax system, the 2018 Budget proposes to increase estate duty from 20% to 25% for estates worth R30 million and more.

To limit the staggering of donations to avoid the higher estate duty rate, any donations above R30 million in one tax year will also be taxed at 25%.

Both measures will be effective from 1 March 2018.