KEY Notes

MARCH 2024

NATIONAL BUDGET 2024 AND TWO POT ROUND-UP

> *"Given our difficult past, and some of the inevitable challenges we have faced as a young democracy trying to find its place in a world marked by a number of new and overlapping crises, it would be easy to indulge in extremes; either of blind optimism or crippling pessimism. We should resist both these extremes."*
> Finance Minister Enoch Godongwana

NATIONAL BUDGET 2024

Finance Minister Enoch Godongwana delivered his third National Budget to Parliament on 21 February 2024.

The budget was delivered in an environment where South Africa's 2023 real GDP growth estimate has been revised downward to 0.6% - the Minister recognised that this was largely due to constraints in power supply, operational and maintenance failures in freight rail and at ports, and high living costs.

This was not the "election budget" that some commentators were expecting but a pragmatic and responsible budget taking account of the constraints and impediments to growth that we face as a nation.

There were very few surprises in the budget – even the tapping of the Gold and Foreign Exchange Contingency Reserve Account (between 2024 and 2027) was widely expected before the speech and has, largely, been accepted as a positive measure provided that the funds are used responsibly.

The following notable tax proposals were announced by the Minister:

- Tax increases totalling R15 billion in 2024/25 will be implemented to alleviate immediate fiscal pressures.
- No inflationary adjustments to the personal income tax tables or medical tax credits in the next tax year - this results in "bracket creep" and essentially means higher income tax for employees who receive salary increases.
- No changes to estate duty, donations tax, capital gains tax, interest exemptions, dividends withholding tax or the tax free savings account limits.
- As was the case in the last two budgets, government again proposed no changes to the general fuel levy or the Road Accident Fund levy – it is estimated that this will result in tax relief of around R4 billion.
- Excise duties on alcohol will increase between 6.7% and 7.2%, while duties on certain tobacco products will increase between 4.7% and 8.2%.

- South Africa will implement a global minimum corporate tax, with multinational corporations subject to an effective tax rate of at least 15%, regardless of where its profits are located.
- Producers of electric vehicles in South Africa will, with effect from 1 March 2026, be able to claim 150% of qualifying investment spending as an incentive to aid the transition to new energy vehicles.

Unclaimed Assets

In September 2022, the FSCA published a discussion paper on unclaimed assets across the financial sector. The Minister has confirmed that the FSCA has considered stakeholder feedback on the discussion paper and will release a comprehensive response in early 2024. This feedback will inform the development of a framework for the identification, monitoring, management and reporting of unclaimed assets, including tracing of beneficial owners of unclaimed benefits.

Social Grants

The Minister outlined that R387.3 billion will be allocated to Social Development to support the various grants and social security funds offered (including the extension of the COVID-19 Social Relief of Distress Grant). The amounts payable in respect of various social grants from the applicable dates are as follows:

Nature of monthly grant	1 April 2023	1 October 2023	1 April 2024	1 October 2024	Increase 2023 to 2024
State old age grant (under age 75)	R2 080	R2 090	R2 180	R2 190	4.8%
State old age grant (over age 75)	R2 100	R2 110	R2 200	R2 210	4.8%
Child support grant	R505	R505	R530	R530	5.0%
Disability grant	R2 080	R2 090	R2 180	R2 190	5.0%
Foster care grant	R1 125	R1 125	R1 180	R1 180	4.9%
Social relief of distress grant	R350	R350	R350	R350	0.0%

Retirement Fund Matters

The budget was again "light" on retirement fund related issues. Notable omissions from issues raised in the 2023 budget (where little to no substantive progress has been made) are the Conduct of Financial Institutions Bill, proposals on auto enrolment and governance of retirement funds (particularly commercial umbrella funds).

Following the changes made last year, there have been **no changes** to the tax rates applicable to lump sum payments from retirement funds on withdrawal, death, retirement or retrenchment this year. For reference, these are set out in an annexure to this Newsletter.

The Minister did, however, spend some time on the so-called "two pot" or "two component" system, which is now scheduled to be implemented with effect from 1 September 2024. A summary of the relevant legislative changes and regulatory guidance is included below.

TWO POT SYSTEM

Revenue Laws Amendment Bill, 2023 ("*RLAB*")

The RLAB, which makes most of the necessary changes to the Income Tax Act ("*ITA*") for the implementation of the two pot system, was introduced in parliament on 1 November 2023. It was passed by the National Assembly on 20 February 2024 and has subsequently been transmitted to the National Council of Provinces for concurrence. This is the last step before the bill is signed into law by the President. As such, there are unlikely to be any further significant changes to the RLAB in the current legislative cycle and industry participants are putting implementation plans in place based on the current draft.

REVENUE LAWS SECOND AMENDMENT BILL, 2024 ("*RLSAB*")

The RLSAB was published on 21 February 2024 and is intended to confirm the effective implementation date for the two pot system as 1 September 2024 and to provide clarity on some of the wording in the RLAB. It incorporates the following:

- **Changes to definitions:** The RLSAB proposes changes to a number of definitions contained in the RLAB to further clarify the intent of that piece of legislation.
- **Intra-fund transfers:** The RLSAB provides for permitted transfers between the various pots within the same fund to be treated as reallocations and, therefore, removes the requirement to obtain a tax directive for such transfers.
- **Maintenance awards:** The definitions of the three pots have been amended to remove references to maintenance awards, as these are taxed elsewhere under the ITA.

PENSION FUNDS AMENDMENT BILL, 2024 ("*PFAB*")

The PFAB, which makes the necessary changes to the Pension Funds Act for the implementation of the two pot system, was introduced in parliament on 30 January 2024. It is currently open for public comment (until 11 March 2024). Notable proposed changes to the Pension Funds Act ("*PFA*"), through the PFAB, are:

- New definitions of "*retirement component*", "*savings component*" *and* "*vested component*" as well as definitions for the "*member's interest*" in each of these components, to align to the definitions being incorporated into the ITA.
- A new definition of "*pension interest*" for the purposes of splitting a retirement benefit on divorce.
- Changes to the definitions of minimum benefits in terms of Section 14B of the PFA for the purposes of both defined benefit and defined contribution funds.
- The replacement of Section 37D of the PFA (which deals with allowable deductions from benefits). Specifically, the proposed changes incorporate relevant provisions which allow for the payment of cash withdrawals prior to exit and protect the rights of certain other parties should a member elect to access part of his or her benefit before exit.
- Incorporating limitations in Section 19 of the PFA to restrict the value of a housing loan or guarantee issued to a member to 65% of that member's minimum benefit (as defined in Section 14B).

Although there appear to be a number of drafting errors and inconsistencies in the PFAB, it is unlikely that these will be resolved in the current draft.

FSCA COMMUNICATION 3 OF 2024 (RF)

FSCA Communication 3 of 2024 was issued by the Deputy Commissioner of the FSCA on 16 February 2024. It sets out the specific requirements regarding the:

- content of rule amendments relating to the two pot system;
- submission of the abovementioned rule amendments; and
- two pot communication to members by retirement funds.

The required rule amendments cover some, but possibly not all, of changes needed to implement the two pot system. Whilst the FSCA requirement in the Communication that "*No other rule changes are to form part of such rule amendment submissions*" may be problematic, following a discussion with the FSCA we understand that other two pot issues may be included in the rule amendment. We also understand that the FSCA is setting up a separate stream for the approval of two pot rule amendments and the approval of these amendments should not be held up by other rule amendments pending approval.

Boards should consider whether they should obtain legal input on the required rule amendments and should also consider submitting the required rule amendments as soon as possible.

TWO POT SUMMARY

A brief summary of the main features of the new system, using the terminology "pots" rather than "components", is provided below:

- **Effective date:** The new system will come into effect on 1 September 2024.

Vested Lump Sum Pot

Accumulated benefit at 1 September 2024, less pro rata portion of seed capital, plus investment return thereon, which may be taken in cash at retirement

Vested Pension Pot

Accumulated benefit at 1 September 2024, less pro rata portion of seed capital, plus investment return thereon, of which at least 2/3rds must be used to buy a pension at retirement

Savings Pot

Seed capital plus 1/3rd of retirement contributions after 1 September 2024, plus investment returns

Retirement Pot

2/3rds of retirement contributions after 1 September 2024, plus investment returns

- **Vested pot:** At the effective date, each member's existing retirement savings will be allocated to a vested pot. For provident fund members on 1 March 2021, the vested pot will be further split into a "vested lump sum pot" and a "vested pension pot". This is done in order to protect historical rights to cash on retirement retained by such members.
- **Savings pot:** One-third of each member's contribution to retirement savings after the effective date will be held in the savings pot and will be accessible prior to retirement (either whilst still in employment or on exit from employment), subject to certain conditions and limits.
- **Retirement pot:** The balance (two-third's) of each member's contribution to retirement savings must be preserved in the retirement pot and, ultimately, be used to purchase a pension on retirement, subject to certain conditions and limits.
- **Seed capital:** The initial seed capital that will be transferred from the vested pot to the savings pot is the lesser of 10% of the value of the vested pot immediately before the effective date and R30 000. As we understand it, the seed capital will be taken proportionately from the vested lump sum pot and the vested pension pot, if applicable.
- **Timing of withdrawals from the savings pot:** Members will be allowed one withdrawal from their savings pot in each tax-year. This withdrawal will be subject to a minimum of R2 000. A second withdrawal from the savings pot in a single tax-year is only allowed on exit from service and if the remaining balance in the pot at that date is less than R2 000.
- **Tax on withdrawals from the savings pot:** Withdrawals from the savings pot before retirement will be treated as income and will be subject to tax at marginal rates. As we understand it, SARS will direct funds to deduct tax at a certain rate on application – this is a "withholding" tax to simplify and streamline the application and payment process. The over- or under-payment of tax will subsequently be corrected as part of the member's next annual tax return. Withdrawals from the saving pot on retirement will be taxed in accordance with the retirement tax table.
- **Withdrawals from the retirement pot on retrenchment:** As we understand it, consideration will, in time, be given to allow access to a portion of the retirement pot on retrenchment to alleviate financial hardship. Such provisions have not been incorporated into the existing RLAB or RLSAB and will not, therefore, apply with effect from 1 September 2024.
- **Defined benefit funds:** Defined benefit funds are included in the new system, although allocations to the various pots and cash payments to members will result in adjustments to pensionable service. Making

these adjustments and allocations is, however, significantly more complex to administer and communicate than for defined contribution funds.

- **Opt-in required for certain provident fund members:** Members who were age 55 years or older and members of a provident fund on 1 March 2021 (and are still members of that provident fund on the effective date), will not be subject to the new system unless they elect to participate. Any such members who elect not to participate in the system will not be able to draw any amounts from their benefit while in service and the rules that applied prior to 1 September 2024 will continue to apply to them.

Communication of the two pot system will be critical to its success. It is a complex system and due to the changes that have been made to the proposals over time, members may not fully understand the implications of the system for them. It is vital that the following issues, amongst others, are properly communicated:

- Not all members will have access to R30 000 on the effective date – members with accumulated savings of less than R300 000 will be limited to 10% of their accumulated savings.
- If a member has less than R2 000 in their savings pot, they will not be able to access any amount in cash.
- The benefit that will be paid will be after the deduction of tax and any fees incurred in making the payment – members may, therefore, get substantially less than expected.
- We expect a large influx of claims on or around the effective date. This means that there will likely be processing delays and payments will not be made immediately.
- Any amount taken in cash before withdrawal or retirement will reduce the amounts available in the future and will adversely impact member's retirement outcomes.
- Withdrawals are only allowed once a tax-year and should, therefore, only be used in an emergency to avoid being unable to access funds when an actual emergency occurs.
- Certain provident fund members will have to opt-in to the system in order to access cash whilst in employment.

ANNEXURE: TAXATION OF RETIREMENT BENEFITS

The taxation of benefits on exit from a retirement fund remains as follows:

DEATH, RETIREMENT OR RETRENCHMENT

Value of lump sum	Rate of tax
R0 to R550 000	0%
R550 001 to R770 000	18% of the amount above R550 000
R770 001 to R1 155 000	R39 600 plus 27% of the amount above R770 000
R1 155 001 and above	R143 550 plus 36% of the amount above R1 155 000

WITHDRAWAL (RESIGNATION OR DISMISSAL)

Value of lump sum	Rate of tax
R0 to R27 500	0%
R27 501 to R726 000	18% of the amount above R27 500
R726 001 to R1 089 000	R125 730 plus 27% of the amount above R726 000
R1 089 001 and above	R223 740 plus 36% of the amount above R1 089 000

The tax on a retirement lump sum or withdrawal lump sum benefit is equal to:

- the tax determined by the application of the tax table to the aggregate of the ***retirement lump sum benefit*** or ***withdrawal lump sum benefit*** and all *previous lump sum benefits* (see Note); less
- the tax determined by the application of the tax table to the aggregate of all *previous lump sum benefits*.

We note that the withdrawal lump sum referred to above is the total amount in the vested lump sum and vested pension pots. Should a lump sum payment be made from the savings pot on withdrawal after 1 September 2024, this will be taxed as income at the member's marginal rate.

Note: *Previous lump sum benefits* include:

- all retirement fund lump sum retirement benefits paid from October 2007;
- all retirement fund lump sum withdrawal benefits paid from March 2009; and
- all other severance benefits paid from March 2011.

Previous lump sum benefits will exclude savings pot withdrawals taxed at a member's marginal rate with effect from 1 September 2024.

IF YOU HAVE ANY QUESTIONS OR WOULD LIKE MORE INFORMATION ON HOW THE ABOVE MAY AFFECT YOUR RETIREMENT FUND, PLEASE CONTACT YOUR KEYSTONE CONSULTANT DIRECTLY.