BIZCOMMUNITY

Retirement reforms in best interest of employees

By Rob Cooper

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Payroll administrators need to start preparing their business systems, processes and workforces for the implementation of the National Treasury's long-awaited retirement reforms during the next tax year (2016/17).

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The reforms will have a significant impact on how employers calculate employees' take-home pay and the tax that they need to pay. The changes will take effect from 1 March 2016; so responsible employers should tell employees before then how it will affect their take-home pay packets.

The reforms, which have proven controversial among South African trade unions, harmonise how all types of retirement funds (pension, provident and retirement annuity) are treated under South African tax law. Historically, South Africa's tax laws have dealt with taxation of pension, provident and retirement fund contributions in different ways:

• An employer's pension fund contributions were not treated as a taxable fringe benefit in the past, while employee contributions were tax deductible subject to an annual limit of the greater of R1,750 or 7.5% of retirement funding income.
• There were no PAYE implications for either the employee or employer contributions to a provident fund.

• The employer's contribution to a retirement annuity fund was taxed as a fringe benefit and included as a deemed employee contribution. Employee contributions were tax deductible subject to an annual limit (the greater of R1,750, R3,500 less the allowable pension contribution or 15% of non-retirement funding income).

New landscape

Under the new tax regime, all retirement fund types will be treated in the same way. An employer's contribution towards any pension, provident or retirement annuity fund will be treated as a taxable fringe benefit for the employee.

The total contribution of the employee and the employer will be tax deductible, up to a limit of the lesser of R350,000 pa or 27.5% of annual remuneration. The value of the fringe benefit will depend on whether the fund is a defined benefit or contribution fund. Most employees will take home slightly more money each month as a result of the changes.

Under these new rules, government is giving low-income and middle-income earners a powerful incentive to save for the future. Treasury is correct to treat retirement reform as an urgent and important matter in a country where some two thirds of people don't have adequate funds for their retirement.

By encouraging people to plan for their retirement, the National Treasury is sacrificing short-term tax revenue in order to relieve pressure on the fiscus in the future. Empowering people to look after themselves in retirement is good for individuals and good for the state. It's also good for payroll administrators in the long term because it standardises and simplifies the tax treatment of retirement fund contributions by the employer and employee.

Only four categories of employee may be worse off in the new tax year:

- Those who earn more than about R1.27m a year;
- employees who benefit from excessively large employer contributions;

- those whose UIF contributions might increase as a result of their higher taxable income (as a result of employers' contributions being treated as a fringe benefit); and

- people whose remuneration will rise from marginally below the tax threshold (R73,650 pa) to above the tax threshold as a result of the new fringe benefit. (But in some cases, the tax deduction may exceed the fringe benefit and move the employee back below the tax threshold).

Treasury is to be congratulated for the transparent manner in which in consulted with labour and business about the retirement reforms. They've done a great job in providing a tax incentive to encourage increased investment into retirement savings, while preventing high-income earners from abusing retirement fund contributions to aggressively reduce their tax burden.

Educate employees

The concerns raised about retirement reform by Cosatu and other parties seem to be counter productive. Employers should help educate employees about what the new laws mean and how they will benefit nearly everyone except the highest income earners.

Labour is concerned about a new rule that will mean provident fund members will only be able to take one third of their retirement benefit as a cash lump sum at retirement. They'll need to annuitise the rest. However, that this rule will apply only to contributions made after 1 March 2016 and for people under 55 years. In addition, only those with savings exceeding R247,500 will need to annuitise their income.

Given South Africa's low rate of savings, this rule makes enormous sense. It could do a great deal to ensure that employees preserve their retirement savings rather than depleting them.

I am looking forward to phase two of retirement reform, which will focus on the complexity and high administration costs of retirement funds. This process could result in simpler and more efficiently managed funds, to the benefit of the member. In three years' time, I think people will understand that these reforms are in their best interests.

ABOUT ROB COOPER

Rob Cooper is a tax expert and director of legislation updates and proposed legislation of Sage VIP.

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