Retirement reform: how you'll score

By Laura du Preez

Making trustees of retirement funds responsible for choosing a default annuity for you on retirement could result in you getting a better pension, delegates to the Pension Lawyers Association conference heard this week.

Kobus Hanekom, head of strategy, governance and compliance at Simeka Consultants & Actuaries, an affiliate of Sanlam Employee Benefits, says there is a huge shift in responsibility to trustees in National Treasury's latest retirement reform proposals, which were released with the Budget late last month.

One of these proposals is that trustees of defined contribution retirement funds be required to identify a default annuity for members and move your savings into it when you retire, unless you ask to move into a different product.

This measure is likely to be introduced when it becomes compulsory for all retirement fund members to buy an annuity with the bulk of their savings when they retire. It is proposed that the measure will come into effect on a date yet to be set, referred to as T-Day, in 2015 or later.

Dr David McCarthy, the retirement policy specialist at Treasury's financial sector policy division, says if the measure is implemented, trustees will be required to ensure members get financial advice until the day after they retire.

He says many members are currently being abandoned by their funds at retirement and "left to the retail market with what is often the largest lump sum they have ever had". In the retail market, you pay retail charges and often have to rely on financial advice that is biased by the commissions paid, he says.

In terms of the latest proposals, trustees will be able to offer as the default an annuity provided by the fund itself or an external annuity.

Hanekom says trustees will be required to identify what they would like the default annuity to look like and they will then be able to call for tenders from product providers. He says that, with their significant negotiating power, trustees will not only be in a position to choose the most appropriate type of annuity for most of their members, but will also be able to negotiate a wholesale price when it comes to the administration and investment charges.

John Anderson, head of research and product development at Alexander Forbes, the country’s largest retirement fund administrator, told Personal Finance he also expects that the costs of annuities will come down when trustees select them on your behalf.

He says trustees will have to apply their minds, because there is no one-size-fits-all annuity, but they could pick a good range of annuities, and they may have a better idea of what is good for members than the members themselves.

McCarthy says large funds may be able to get a better deal for members on annuities because the funds will have records of their members’ mortality rates.

He indicated that such a move could also increase competition in the living annuities market, which may further reduce charges on these products, even if you opt for an annuity other than the default.

Hanekom says another advantage of the default annuity is that a member’s investments before retirement could be aligned to those in the annuity, and the transfer could then be made at a lower cost.

He says no commission may be charged on these default annuities. The fund will be required to pay the finanical adviser a salary or pay on a fee-for-time basis.

Alexander Forbes’s research indicates that retirees may still want to be presented with all the options, but if advice is provided by funds on a salary or fee basis, this could be very beneficial, Anderson says.

Treasury proposes that there be some protection for trustees if they give you access to commission-free financial advice when you retire.

Hanekom says this means that if your trustees follow a sound process in selecting an annuity for you and other fund members, and a few years down the line the provider runs into trouble, the trustees may not be held liable for your loss.

There are currently two main types of annuities: living annuities and guaranteed annuities.

A guaranteed annuity guarantees you a particular pension until you die.

With a living annuity, you need to invest your accumulated capital to provide an income for the rest of your life, and you take the risk that your savings and the returns on it will, in fact, be sufficient to do this.

Many people opt for living annuities because they expect that they will be able to get a better pension by making their own investment choices. But you could end up worse off than if you had taken a guaranteed annuity.

Treasury’s proposals state that it will be possible for trustees to choose a living annuity as the default product, provided it conforms to certain requirements, including those on charges, investment choices and the rates at which you can draw an income.

McCarthy says Treasury also plans to amend regulations so that it will be easier for you to split your retirement savings between a living annuity and a guaranteed annuity. This will enable you to guarantee a portion of your income while taking a bet on the other portion that it will be sufficient for your retirement.

FUNDS NEED TO GEAR UP FOR T-DAY

Retirement funds will need to review their rules ahead of T-Day, the day on which the tax deductions for contributions to retirement funds are expected to change, the Pension Lawyers Association heard this week.

Beatrie Gouws, the director of personal income tax and savings at National Treasury, says Treasury is proposing that your employer’s contribution to your retirement fund be included in your taxable income as a fringe benefit, but that you be entitled to deduct those contributions, together with any you make, up to 27.5 percent of the higher of your remuneration or taxable income.

Your employer’s contribution will include any contributions to a group life or permanent disability scheme.

The deduction will also be limited to R350 000 a year in order to ensure the system is equitable, Gouws says.

Treasury is aiming for T-Day to be on March 1, 2015, in order to coincide with the start of the personal income tax year, she says.

To achieve this, Gouws says, draft amendments to legislation will be published this year.

If the proposal is adopted, you may be able to deduct a greater contribution amount for tax purposes, because the base to which the percentage cap applies will be broader because it will be the higher of your remuneration or taxable income, Gouws says.

Your remuneration includes all employment income, whether it forms part of your basic salary or is more ad hoc in nature, such as overtime, bonuses and income attributable to employee share schemes.

She says remuneration and taxable income were chosen because they should be easier for members to understand than a concept such as retirement-funding employment and non-employment income.

She says that where employees are on a total cost-to-company package, funds may wish to amend their rules in order to allow members to increase their contributions.

Gouws says that employers can safely facilitate tax deductions for you of up to 27.5 percent of your remuneration, but they would be unwise to facilitate tax deductions on your taxable income if it is higher than your remuneration – for example, if you make a taxable capital gain or earn rental income. You will have to claim the tax deduction from these kinds of income on assessment or through the provisional tax system.

Currently, you cannot claim against taxable capital gains deductions for contributions made to, for example, a retirement annuity fund.

Gouws says the current dispensation for employer-provided group life or disability schemes will remain so that the employer premium is taxable as a fringe benefit but the payout is tax-free. However, if your employer is contributing to a retirement fund which in turn provides you with a group life or disability scheme – a so-called approved scheme – these contributions (and the payout) will continue to enjoy the tax dispensation applicable to retirement fund contributions and payouts.

Treasury is also proposing to remove the deduction you may currently enjoy for premiums paid to an income protection policy. However, the monthly income paid from these policies will then be tax-free.

If your employer pays these premiums on your behalf, this will remain a fringe benefit for you, Gouws says, but you will no longer enjoy a tax deduction for the premiums. No introduction date has been set for these amendments.

Gouws says that income protection schemes can only be employer-provided and not provided by a fund through an approved scheme because, legally, funds can pay out only on retirement or death and not on disability.

PENALTIES ON LIFE RAs 'STILL EXORBITANT'

The Pension Funds Adjudicator says her office is "greatly disappointed" that it is unable to help members with "excessive" charges for stopping or reducing their contributions to life assurance retirement annuities (RAs).

Muvhango Lukhaimane, Deputy Pension Funds Adjudicator, told the Pension Lawyers Association conference that her office is forced to make determinations on these charges in line with the Statement of Intent.

In 2005, life assurers and the then Minister of Finance, Trevor Manuel, signed the Statement of Intent, agreeing that the life industry would, in future, limit the penalties on RAs if you reneged on the terms of the contract.

Despite these limits, Lukhaimane says the charges are exorbitant, and they impoverish members who need to make their policies paid up or transfer their policies to other companies.

She says the way in which the charges are levied and the underlying actuarial principles differ drastically from one life assurer to another and are often not understandable.

The adjudicator says her office is at risk of being viewed as complicit in the charges that are levied because it cannot rule against those that are in line with the Statement of Intent.

She says it is very disheartening, because most of the time the charges are levied on the savings of self-employed people who fall into financial difficulties.

Lukhaimane says she is glad that the National Treasury is looking into the costs of saving for retirement, but she does not understand why the industry does not reform itself when it comes to penalties on RAs.

The Statement of Intent limits the penalties that can be levied on your savings to 35 percent of the policy’s value if it was sold before 2009 and to 30 percent of its value if it was sold after January 1, 2009, she says.

Members also need to be educated about the fact that they are responsible for the selection of investment portfolios and monitoring the performance of these in RA policies, as they are often unhappy with the returns, she says.

The adjudicator says another source of heart-breaking complaints is bargaining council funds. Bargaining councils are formed by trade unions and employers’ organisations. They can make collective agreements, solve labour disputes and establish savings schemes for employees.

Lukhaimane says the governance of bargaining council funds “falls between the cracks”, as these councils are often unable to force employers to contribute to funds regularly and timeously as required by the Pension Funds Act.

Often these councils commence legal proceedings against employers, precluding the adjudicator’s office from granting the fund relief.

The adjudicator says it is important that retirement funds inform their members of matters related to their investments. She says, for example, that, as a member, you need to be told when your savings will be disinvested and moved into a cash investment when you withdraw or retire from the fund.

Also, funds that invest in products that declare bonuses, such as smoothed-bonus policies, need to have clear rules about what happens if you leave a fund after an interim bonus, rather than a final bonus, has been declared on the investments.

Lukhaimane says there can be delays in the declaration of a final bonus, and often the rules are silent about how the interim bonus will be treated if a member leaves before the final bonus has been declared.

Finally, the adjudicator says funds should invest where they say they are going to invest, and if trustees decide to change the investments, they must inform members.

Pravin’s big retirement changes on track

You need to gear up your retirement planning to meet T-Day and P-Day, when government will implement major changes to the R3-trillion retirement savings industry.

T-Day and P-Day are days when retirement fund reforms are scheduled to be implemented in or after 2015, with legislation based on government's latest proposals for retirement reform being put before Parliament this year. The proposals are outlined in a discussion paper titled "2013 Retirement reform proposals for further consultations".

This latest discussion document, released this week with the Budget, consolidates reaction to four discussion documents published last year on various aspects of retirement reform, including the preservation and taxation of retirement savings.

Apart from T-Day and P-Day, a number of other reforms will be implemented to boost the protection of your retirement savings, including the enforcement of better behaviour by your retirement fund trustees and measures aimed at reducing costs. The reforms also propose to bring statutory funds, such as the Government Employees Pension Fund and the Transnet funds, under the ambit of the Pension Funds Act, giving members the rights enjoyed by members of non-statutory pension funds.

T-Day

The recommendations for the still-to-be-set T-Day will affect the taxation of your retirement fund contributions. The recommendations change those made last year by Finance Minister Pravin Gordhan, which were scheduled for implementation on March 1, 2014. The latest recommendations are:

* Your employer's contributions will be added to your taxable income as a fringe benefit;

* You will be able to deduct both your and your employer's contributions to a pension fund, provident fund or retirement annuity (RA) fund up to 27.5 percent of the greater of remuneration or taxable income;

* The premiums you pay on group risk insurance will be

included in the amount you may deduct from your taxable income;

* There will be a rand cap of R350 000 on the total amount you may deduct from your taxable earnings in any tax year;

* Contributions in excess of the annual cap may be rolled over to future years when you may not reach the cap amount;

* Any non-deductible contributions will be added to your tax-free lump sum at retirement; and

* From T-Day, any new contributions made to a provident fund will be subject to the same annuitisation rules as pension funds, namely that at least two-thirds of the savings must be used to purchase a pension at retirement. Any provident fund savings made before T-day, and any investment growth on those savings, will not be subject to the new pension purchase requirement.

P-Day

Government is proposing tighter controls on preserving retirement savings, but it will allow you to access savings before retirement during periods of unemployment.

However, vested rights will be protected to avoid a repeat performance of people resigning their jobs or getting divorced to get their hands of their retirement savings.

Recommendations for the preservation of retirement savings are:

* From P-Day, all retirement funds will be required to identify a default preservation fund to which members' savings can be transferred if they withdraw from the fund before retirement. The use of an existing retirement fund to preserve savings for retirement is already a no-cost option for members who, if the fund rules allow, can stay on as deferred members with their savings protected and growing

until normal retirement age. However, currently, no withdrawals are allowed. This will change with the new withdrawal rules.

* Currently, you are limited to one withdrawal from a preservation fund before retirement, but the withdrawal may be 100 percent of your savings. The new proposal is to allow for an income stream in periods of unemployment, allowing for one withdrawal a year.

* Withdrawals will be based on a formula. The proposed annual withdrawal will allow members of preservation funds to withdraw an amount that is the greater of the state old age grant (R1 260 from April 1) or 10 percent of their initial preservation fund deposit, excluding any portion to which vested rights apply. Any unused withdrawal amounts may be carried forward to future years.

* From P-Day, retirement fund divorce settlements will be subject to the proposed new preservation withdrawal rules allowing for a limited income stream.

Consideration is also being given to relaxing the preservation requirements of RA funds, from which you currently cannot make any withdrawals before the age of 55. (When you do reach 55, two-thirds must be used to purchase a pension).

Treasury is considering allowing RA fund members to transfer their balances to preservation funds, under conditions that will prevent them from seeking out additional tax advantages. The conditions may include preventing individuals who have transferred money out of an RA fund from rejoining that fund, or, alternatively, from receiving a tax deduction in respect of any RA contributions, for a period.

TREASURY INTENT ON OVERHAUL OF LIVING ANNUITIES

Investment-linked living annuities (illas) are due for a major overhaul to ensure that pensioners using them are not left financially destitute before they die because of high costs, poor advice, wrong investment choices and drawdown rates that are too high.

Life assurance companies are set to lose their stranglehold on the provision of illas, with government proposing that the requirement of a life assurance licence to sell illas be dropped.

It is proposed that collective investment scheme management companies such as unit trust and exchange traded fund companies be allowed to sell illas without, as they currently need to do, registering as a life assurance company or renting a life assurance licence.

National Treasury hopes this will increase competition and bring down costs.

It says most respondents to an earlier discussion paper pointed out that an important factor underlying the choice of annuity at retirement was that people with a low level of savings tended to choose illas in the hope that, because they allow for higher initial pension payments than conventional annuities, they could maintain their living standards.

Most respondents were in favour of reforming, rather than replacing illas.

Treasury says:

* Many of the difficulties associated with illas may be direct or indirect consequences of the ways in which intermediaries, including investment platforms, are paid. The Financial Services Board (FSB) is already investigating these costs as part of its Retail Distribution Review on commissions paid for financial products, including illas. This review will include an investigation into the payment of rebates by collective investment schemes to linked-investment

service providers, which are currently the main source of illas.

Illas are also part of the scope of the Treating Customers Fairly initiative.

* Consideration is being given to easing rules on using multiple types of pensions to allow retirees to choose different combinations from existing, relatively well-understood pension products.

* Proposed default illas, whether provided within or outside a retirement fund, will be permissible as a default option only if they meet strict conditions, including design criteria and limits on investment choices, drawdown rates and costs. Collective investment scheme managers will also be able to provide retirement funds with default illas, provided they meet the conditions.

Treasury says the progress of these reforms will be monitored through detailed compulsory reporting by product providers on annuity (pension) purchases made by individuals retiring from funds, investment charges and the asset mix of illas, and the purchase prices and terms of conventional annuity policies.

GOVT PONDERS COMPLEXITY OF SECURITY FOR LOW EARNERS

Government must still spell out the details of how it intends extending the retirement system to all employed individuals, particularly those in low-income groups and in irregular employment, who are mainly excluded from the current system and rely entirely on the social old-age grant, which will be increased from R1 200 to R1 260 a month.

The Budget Review says the retirement reform proposals released with the Budget “will lay the foundation for the eventual introduction of a mandatory tier of a comprehensive social security system that provides death, disability and retirement cover to all workers”.

The backbone of the extended system is likely to be the proposed National Social Security Fund (NSSF).

Patrick Craven, spokesperson for trade union federation Cosatu, in reacting to the Budget proposals, says the federation is increasingly frustrated by government's failure to introduce comprehensive social security that will ensure that nobody falls through the safety net.

Cosatu also rejects the piecemeal reforms of the retirement funding system and wants retirement reform to be part of comprehensive social security reform.

But in its discussion paper, Treasury says the situation is complex. Currently, about half of formally employed workers are members of an employer-sponsored retirement fund. An analysis based on a labour force survey carried out in 2010 by the Centre for Research into Economics and Finance in Southern Africa indicates that 86 percent of workers who don't belong to retirement funds earn less than the tax threshold, indicating that they receive no tax benefit for saving for retirement. Of these, nearly 40 percent work in sectors where employment can be erratic.

PwC 2013 Tax Budget Comments

PwC 2013 Tax Budget Comments

Personal Income Tax

Higher income tax earners will have R231,25 less income tax to pay per month, assuming they have a basic annual taxable income of R700,000. Lower income tax earners will pay R86 less income tax annually, assuming they have an annual basic taxable income of R165, 600.The individual threshold for submitting a tax return was raised from R120,000 to R250,000 per year. This means that taxpayers that have taxable income of less than R250,000 annually will not be required to submit tax returns.

Karen Botha, Senior Manager, Tax, PwC

Relief for small businesses

The increase in the turnover threshold for small business corporations from R14 million to R20 million is welcome in that it will incentivise small businesses and stimulate this industry.

Cor Kraamwinkel, Associate Director, International Tax, PwC

Business taxes: Restricting debt to prevent base erosion

The proposed restrictions on debt financing will in all likelihood have a negative impact on the ability of South Africa to attract new foreign direct investments, and may necessitate debt restructuring of existing investments.

Cor Kraamwinkel, Associate Director, International Tax, PwC

Uniform cross-border withholding to prevent base erosion

The proposed introduction of a withholding tax on cross border services fees, to be effective from 1 March 2014, may increase the cost of doing businesses in South Africa for groups relying on centralised global shares service centres. The possible relief from such tax offered by certain double taxation agreements will become of key consideration for such multinational groups.

Cor Kraamwinkel, Associate Director, International Tax, PwC

Retirement Reforms

Yet again, the proposals mention that retirement savings should be encouraged, but from March 2014 an employer’s contribution to retirement funds on behalf of an employee will be treated as a taxable fringe benefit. Although the capping amount will not have a significant effect on lower income earners as they will now be allowed to have a tax deduction of 27,5% if they are under the age of 65, the high income earners will have no reason to save excess cash for their retirement as their contributions will be capped at R350,000. Contributions above the capped amount will be carried forward to future tax years. This begs the question as to whether this contradicts the incentive to save.

Karen Botha, Senior Manager, Tax, PwC

Exchange Control Relaxation

Government recognises the need to improve the flexibility of South African companies carrying on business abroad, especially with regard to exchange controls and currency. Proposals to allow for a South African company to carry on treasury operations in South Africa free of exchange control restrictions and in a non-ZAR functional currency are to be welcomed. Also welcomed, are proposals around a South African foreign holding company, as a subsidiary of a JSE listed entity that may operate outside the shackles of exchange control.

Elandre Brandt, Partner, International Tax, PwC

Government shows it is serious about employment of youth

One of the main tax proposals for 2013 as stated in the Budget Speech is the addressing of youth unemployment through an employment tax incentive targeted to support young workers. The aim of this is to help young people to enter the labour market, gain valuable experience and have access to career opportunities. In conjunction with this initiative the proposed Employment Services Bill of 2010 will assist with addressing the unemployment of young people through the creation of work schemes.

Candice Aletter, Tax, PwC

Restricting debt to prevent base erosion

It appears that the current discretionary regime relating to the allowance of interest deductions on acquisition debt is to be replaced by a non-discretionary regime. The tax certainty/predictability that such a non-discretionary system is to afford taxpayers is welcomed.

Cor Kraamwinkel, Associate Director, International Tax, PwC

VAT registration

VAT registration will be streamlined to ease the compliance burden while guarding against fraud.

Currently, obtaining a VAT registration can be an unnecessarily expensive and time-consuming process. Often the requirements change without notice which leads to huge frustration and can result in the loss of business for the prospective registrant. This attempt to streamline is a critical step in reducing the administrative burden on business.

Gerard Soverall, Partner, Indirect Tax, PwC

VAT registration of foreign businesses

Foreign businesses and providers of digital goods and services in South Africa will be required to register as VAT vendors. This proposal is in line with international trends, such as regulations adopted by the European Union requiring such suppliers to register for VAT in the country where the consumer resides. Suppliers of digital goods and services will have to register for VAT

This change has major compliance implications for foreign suppliers of digital products. Traditionally, this has been extremely difficult to police because of the ambiguity in the VAT law,SARS lack of resources and the proliferation of digital suppliers.

Because of the difficulty in policing this requirement, this new approach is more likely to impact the larger, well known global brands. Such suppliers are easier to detect. This might also be a reaction to the recent furore in Europe over well know business not paying their “fair share” of national taxes.

This change is also likely to affect foreign suppliers of software, data, etc. This might be an unintended consequence.

Gerard Soverall, Partner, Indirect Tax, PwC

Understatement penalties

The penalty provisions will be refined and relief will be provided for bona fide errors.

The introduction of the Tax Administration Act in October 2013 has created huge difficulty for taxpayers, particularly in terms of the scale of the penalties and rigidity of the penalty regime. This is a welcome development in that, hopefully, the punishment of the taxpayer might now be commensurate with the error.

Gerard Soverall, Partner, Indirect Tax, PwC

Tax policy research projects

The National Treasury will research the VAT treatment of financial services and VAT apportionment within the financial sector during 2013/14.

This research is part of a continuing effort on National Treasury and SARS’s parts to understand the financial services sector from a VAT perspective and to ensure that the entitlement to deduct VAT on expenses is aligned fully with the taxable activities of the taxpayer.

Gerard Soverall, Partner, Indirect Tax, PwC

Deductibility of interest on restructuring debt

Indications from the budget speech are that there is an intention to move away from the recently enacted section 23K provision which gives SARS the discretion to determine the level of deductibility of interest incurred on debt raised for certain restructuring transactions. Although not clear, indications are that objective criteria will be put in place to determine deductibility. This will certainly be welcomed, given the time consuming and administratively inflexible approach required by section 23K which delays certainty on transactions and hampers the ability of business persons to act rapidly.

Elandre Brandt, Partner, International Tax, PwC

Increase in vehicle CO2 emissions tax

The proposed increase of 20% or more in motor vehicle CO2 emissions tax is likely to play an ever increasing role in influencing customers to buy passenger vehicles with lower CO2 emissions.

Cor Kraamwinkel, Associate Director, International Tax, PwC

Multiple sources of Income

If you receive income from more than one source, usually at the end of the tax year you'll be met with a tax shortfall which you must pay across to SARS.

SARS refers to this as the "aggregation rate" where the PAYE withheld from each source of income does not take into account the income from the other sources.

It has been proposed that this anomaly will be addressed as follows:

1. Requesting employers to withhold PAYE at a higher rate;

2. Holding the employers responsible for the “extra PAYE” due;

3. Advising employers which of their employees receive income from more than one source; and

4. Providing temporary relief for widows and widowers.

This seems like more administration SARS may not be able to handle.

Nokuthula Modiga, Consultant, Tax, PwC

Corporates expected to contribute even less to overall tax collections

Predicted tax collections for 2014 show a total of R898 billion, of which corporates are expected to contribute R192 billion (21.4% – prior year 21.8%), indirect tax R333 billion (37.1% – prior year 36.9%) and individuals R306 billion (34.1% – prior year 33.8%), with other taxes making up the balance. It is clear that tax collections are being driven by individuals and the end consumer, with corporates gradually contributing less.

Elandre Brandt, Partner, International Tax, PwC

South African companies expanding internationally

The proposed incentives relating to the Gateway subsidiary for African and offshore operations falls short of providing significant tax incentives to attack regional hub activities to South Africa when compared with traditional low/ tax free jurisdictions used to house such functions.

Cor Kraamwinkel, Associate Director, International Tax, PwC

Special economic zones

The Finance Minister confirmed the intention to proceed with special economic zones in the 2012 Budget Speech. Incentives would include a reduction in the corporate tax rate of 15% and incentive allowances. This may prove a useful incentive in the job creation drive and regeneration of certain targeted zones.

Cor Kraamwinkel, Associate Director, International Tax, PwC

Tax-free interest

The annual thresholds for interest income for individuals below 65 increased by 4.39% from R22 800 to R23 800 and for individuals over 65 increased by 4.55% from R33 000 to R34 500. It was also mentioned that it will not be adjusted for inflation in future years. This can only be due to tax-preferred savings and investment accounts that will be introduced by April 2015.

Odette Pfeifer, Consultant, Tax, PwC

Withholding Taxes

In 2011, proposals to revise the withholding regime applicable to royalties paid to non-residents were announced. The announcement was coupled with an announcement that a withholding tax on interest paid to non-residents would also be introduced. While the revision of the regime relating to royalties was arguably necessary, the introduction of the regime relating to interest was directly aimed at widening the tax base.

Initially, it was proposed that the revised royalty and the new interest withholding regimes would apply with effect from 1 January 2013. In order to harmonise the systems and to address anomalies in the initial legislation, the date of introduction was postponed until 1 July 2013.

Presumably, in an effort to broaden the tax base and to align the South African tax system with other tax systems, it has been proposed that a withholding tax on service payments be introduced with effect from 1 March 2014. Apparently, in order to harmonise this new regime with the royalty and interest withholding regimes, the introduction date of those regimes has again been postponed to 1 March 2013.

The logic behind the introduction of the withholding tax on services is questionable. South Africa already suffers from a severe skills shortage, and to impose this tax would increase the cost to non-residents of providing these services in South Africa. The introduction of the tax (coupled with the withholding tax on interest) appears to fly in the face of other initiatives aimed at encouraging foreign direct investment.

Greg Smith, Senior Manager, Tax, PwC

Miscellaneous Indirect Changes: VAT

Motor cars

VAT recovery on a racing car or cart that is acquired by a vendor partly for recreational use and partly for business use (for example, advertising purposes) will be blocked. This falls into this exclusion.

Repossession of goods

Both the debtor and the creditor in an instalment credit agreement will be deemed to make a supply of goods under an instalment credit agreement.

Future supplies of services

A special time of supply rule for services will be introduced when the consideration for that service cannot be determined upfront due to a contingent future event (for example, share price and exchange rate).

In-flight entertainment

VAT on in-flight entertainment (movies and video games) is currently disallowed even though it is ancillary to the flight. VAT on this in-flight entertainment will no longer be disallowed (just as meals and refreshments, which are not disallowed).

Supplies between connected persons

Special time-of-supply rules apply to transactions between connected persons. The purpose of these rules is to prevent artificial deferrals. It is proposed to relax these rules where the input VAT recovered matches the output tax declared by the supplier.

Gerard Soverall, Partner, Indirect Tax, PwC

Tax invoices issued in foreign currency

Under the current law, a valid tax invoice must be stated in rands. The VAT Act will be changed to deal with the scenario in which the transaction is conducted in foreign currency. Foreign currency invoices will be allowed to be converted to rands at the spot rate agreed upon by the parties. In the absence of an agreement, the spot rate on the date of supply will be used.

Gerard Soverall, Partner, Indirect Tax, PwC

Conversion from a share block scheme to a sectional title

Notional input tax will be allowed on the conversion of a share block company to a sectional title. This was previously considered to a “non-supply” for VAT purposes with no output tax due but with a corresponding blocking of input tax relief. This mismatch will be removed.

Gerard Soverall, Partner, Indirect Tax, PwC

Square Kilometre Array

The Square Kilometre Array, an international collaboration to build the world's largest radio telescope, is eligible for income-tax exemption under existing public-benefit provisions. VAT relief will be provided through a refund mechanism or the zero-rating of consideration received by the project and for imported goods and services.

Gerard Soverall, Partner, Indirect Tax, PwC

Apportionment – non-financial sectors

The default apportionment method (the standard method) is based on turnover. It can be inequitable because there may not be a direct correlation between expenditure incurred and the turnover generated. It is proposed that the application of this method be re-evaluated particularly as it concerns non-financial institutions.

South Africa Details Pensions Consultation

by Lorys Charalambous, Tax-News.com, Cyprus

Further details have been provided of the Government's public consultation on its proposals to reform the retirement industry in South Africa, with a focus on the taxation, governance and harmonization of retirement funds.

The revised proposals and new consultation were announced by Pravin Gordhan, the South African Minister of Finance, in his

2013 Budget Speech on February 27. The proposals follow a series of technical discussion papers with draft proposals that were issued in 2012, after the Minister's 2012 Budget announcements.

Both formal and informal consultations were held with stakeholders during 2012 in respect of those papers, and the Government has now developed the revised policy proposals for further consultation with a closing date of May 31, 2013. Following that, draft legislation to give effect to the proposals will be introduced over the course of 2013.

Firstly, it was pointed out that South Africa is an "outlier" among countries of a similar income level in that it does not have a statutory requirement for pension provision and, as a consequence, a large number of employers provide retirement and insurance funds as a condition of employment.

However, coverage of such arrangements is uneven, with workers' access to an occupational fund dependent on factors such as income, employer size and economic sector. According to research based on the 2010 Labor Force Survey, only 32% of people earning below the tax threshold and only 36% of workers at companies with fewer than 50 employees have access to an occupational retirement fund.

The Government's contribution to occupational and individual retirement arrangements is seen as incentivizing contributions via the tax system, and regulating retirement funds. The reforms now being proposed are, in fact, also intended to lay the foundation for the eventual introduction of a mandatory part of a comprehensive social security system that provides retirement cover to all workers.

With regard to the taxation of retirement funds, from an effective date in or after 2015, called T-day, employer contributions to retirement funds will become a fringe benefit in the hands of employees for tax purposes.

Individuals will be able to receive a tax deduction on employer and employee contributions to a pension fund, provident fund or retirement annuity fund up to 27.5% of the greater of remuneration and taxable income. For equity reasons, an annual ceiling of ZAR350,000 (USD39,600) will apply.

The tax treatment of contributions to pension, retirement annuity and provident funds will be harmonized, allowing provident fund members also to receive a tax deduction on their own contributions. Vested benefits would be protected in provident funds at the date of implementation.

However, it is proposed, subject to public consultation, that future contributions made to provident funds after an agreed date would be subject to the same annuity requirements applicable to retirement annuity and pension funds. That requirement would not apply to provident fund members older than 55 years at the date of implementation.

Contributions in excess of the annual caps may be rolled over to future years. At retirement, where any non-deductible contributions remain, they would be set off against any lump sum or annuity income before tax is calculated, to avoid double taxation.

With regard to non-retirement savings, the Government intends to proceed with the implementation of tax-preferred savings and investment accounts. All returns accrued within these accounts and any withdrawals would be exempt from tax.

The account will have an initial annual contribution limit of ZAR30,000 and a lifetime limit of ZAR500,000, to be increased regularly in line with inflation. The new accounts will be introduced by 2015, and will co-exist with the current tax-free interest income dispensation.

With effect from March 1, 2013, tax-free interest-income annual thresholds will be increased from ZAR33,000 to

ZAR34,500 for individuals 65 years and over, and from ZAR22,800 to ZAR23,800 for individuals below 65 years. These thresholds may not be adjusted for inflation in future years.