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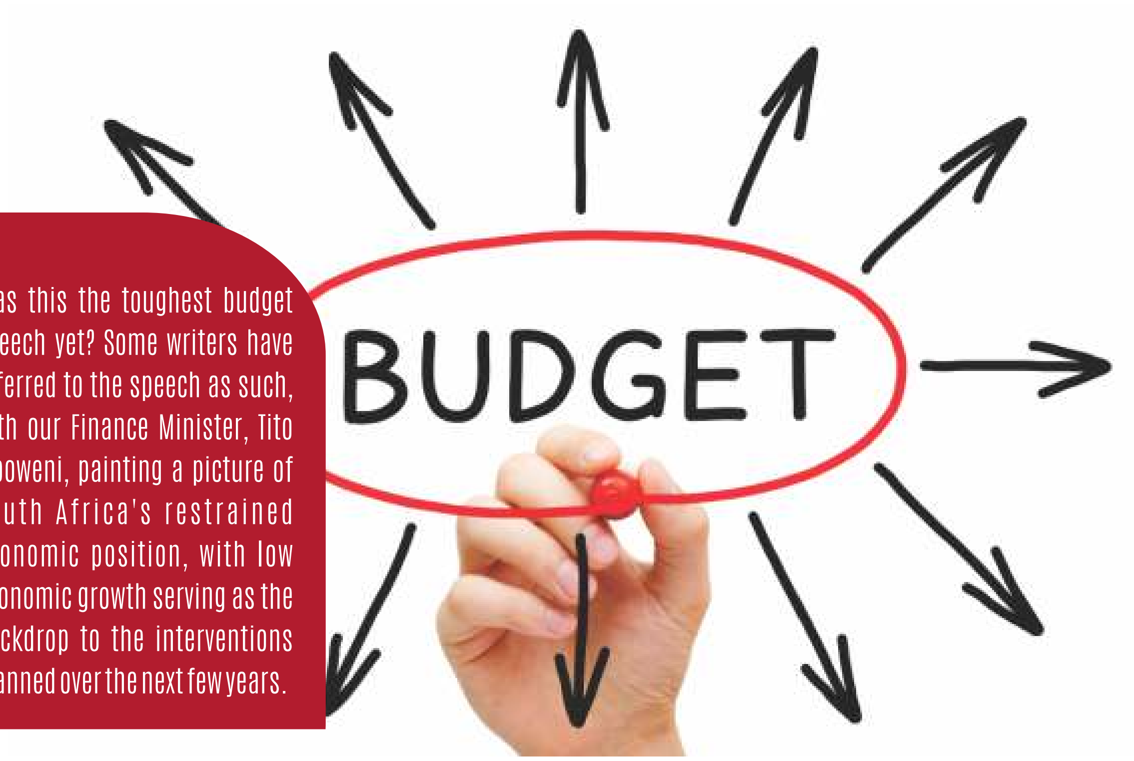

Was this the toughest budget speech yet? Some writers have referred to the speech as such, with our Finance Minister, Tito Mboweni, painting a picture of South Africa's restrained economic position, with low economic growth serving as the backdrop to the interventions planned over the next few years.

National Budget 2020

Finance Minister Tito Mboweni delivered his 2020 budget speech on 26 February 2020, where he outlined the state of South Africa's finances and the government's spending in the year ahead.

In this publication, we highlight matters related to employee benefits as raised in the budget documentation, including the Budget Review.

General

We start first with a number of issues that may have a general effect on retirement funds going forward.

Employment

National Treasury observes that job creation and wage growth are not easily achievable in the context of low economic growth. In 2019, just 11.3 million people had formal, non-agricultural jobs. Annual private-sector wage growth per worker was just 2.4 per cent in the first nine months of 2019, compared with public-sector wage growth of 7.2 per cent.

Income tax collections from individuals have been affected by "sluggish employment and wage growth".

The Budget Review notes that public-service compensation has grown by about 40 per cent in real terms over the past 12 years, thus remuneration growth is increasingly out of line with the rest of the economy. The 2019 Budget announced wage-bill measures amounting to R27 billion. These measures included provision for early retirement by certain public servants. National Treasury notes that take-up of the early retirement initiative has been slower than they anticipated with only one department finalising implementation during 2019/2020. Other departments have submitted proposals which still need to be processed.

Fighting financial crime and corruption

- The Financial Action Task Force (FATF) will evaluate and make recommendations about South Africa's financial intelligence system with a view to preventing money laundering, terror financing and financing of the proliferation of weapons of mass destruction; and
- Government is currently preparing legislative and regulatory proposals to combat sophisticated financial crimes, unexplained wealth and suspicious financial flows. National Treasury explains that this may include expanding the scope of suspicious transaction reporting, facilitating greater cooperation and information sharing between relevant authorities, and expanding capacity in the areas of analysis, enforcement and investigation. These proposals will complement the recommendations emerging from the FATF review.

Revitalising the South African Revenue Service (SARS)

Previously it has been found by a commission of enquiry that there was a "massive failure of governance and integrity" at SARS under the former Commissioner. The revitalisation of the South African Revenue Service (SARS) is underway. This rebuilding is obviously vital to the financial success of South Africa going forward and would need to contribute to increased tax revenue over the medium term.

SARS is reviewing its procurement processes. Contracts that did not represent value for money have not been renewed. A number of senior officials implicated by the Commission of Enquiry have left and experienced staff have returned to their roles.

Treasury states that the new Commissioner is focusing on stabilising the organisation, re-establishing integrity and compliance functions and restoring employee confidence and public trust.

Pay-as-you-earn and personal income tax administration reform

The pay-as-you-earn (PAYE) process and legislation will be reviewed with a view to implementing a more modern, automated process for employers. Over time, National Treasury expects this reform to mean that most individual salaried taxpayers will not have to file personal tax returns.

Financial Institutions, including retirement funds

Retirement fund lump sum tax tables remain unchanged.

The proposals set out below have been specified for various financial institutions. A retirement fund is a financial institution.

The Conduct of Financial Institutions Bill (COFI)

COFI is principle-based legislation that aims to significantly streamline the legal framework for the regulation of the conduct of financial institutions (including retirement funds). In addition, COFI will give legislative effect to the market conduct policy approach, including implementation of the Treating Customers Fairly ("TCF") principles. These principles currently have little legal backing. COFI is designed to replace the conduct provisions of most existing financial sector laws (for example the Pensions Funds Act). COFI is currently still in Bill form and is not an Act, nor effective as yet.

In 2018, the Conduct of Financial Institutions Bill was published for public consultation. Public workshops were held during 2019. National Treasury states that over 800 pages of comments were received on the Bill, including feedback on governance requirements, retirement funds, payment services, financial markets and wholesale banking.

There has been some talk that the Bill would not be published for another round of comment after revisions have been made as a result of the last comments received. But National Treasury states in the Budget Review that "A revised draft of the bill will be published for public comment and tabled in Parliament in 2020".

This is a very important piece of legislation and will lead to large scale changes in the way that the conduct of financial institutions is regulated and monitored by the Financial Sector Conduct Authority (FSCA).

Retail Distribution Review (RDR)

National Treasury simply notes that the Financial Sector Conduct Authority published an update of its retail distribution review in December 2019 and that significant progress in implementation has been made. We know that due to the transformation to the FSCA (from the old Financial Services Board) the FSCA may be behind where it would ideally want to be with RDR, but that it is making progress.

Financial Sector Levies Bill

This long-awaited Bill sets out the levies to be paid to cover the costs of the Prudential Authority and FSCA's regulation and supervision as well as the functioning of Ombuds. Occupational funds, retirement annuity funds, commercial umbrella funds, pension fund administrators and long-term insurers are required to pay the levies.

National Treasury states that the Financial Sector Levies Bill will be submitted to Parliament during 2020.

Transformation and financial inclusion

The Financial Sector Transformation Council has established eight subcommittees to review the targets in the Financial Sector Code to strengthen transformation of the financial sector. To date, the committees have developed targets for management control, skills development, socio-economic development, consumer education and retirement funds.

A paper to establish a policy framework for financial inclusion in South Africa will be published for public comment in 2020.

Transformation and inclusion requirements for financial institutions, such as retirement funds and administrators, are set out in COFI (currently draft legislation) and include the requirements for policies, goals and reporting. Under COFI, it is envisaged that the FSCA will be able to take direct regulatory and enforcement action against financial institutions that do not comply with their own transformation objectives and goals.

Innovation hub

National Treasury state that the Intergovernmental Fintech Working Group is introducing an online fintech portal with an innovation hub, which will clarify the applicability of financial services regulation and support the testing of new products and services.

Unclaimed benefits

The FSCA and the retirement funds industry have been concerned about the level of unclaimed benefits for many years now and has put various mechanisms in place to try to assist consumers to be paid benefits owed to them. National Treasury mentions that retirement funds and the Guardian's Fund are sometimes unable to trace beneficiaries, resulting in unclaimed benefits or money.

National Treasury go on to state that “the money is invested in government bonds and other instruments” and that “these investments are being considered in the mobilisation of funding for infrastructure”. It is not clear what this means, but it appears that the assets underlying unclaimed benefits may be used to fund infrastructure development in South Africa.

It is also stated that Government will introduce legislation later this year to centralise the unclaimed benefits and monies and establish a central registry of all members of retirement funds. This contentious idea of a centralised unclaimed benefits fund has been on the cards for some time.

Retirement fund reform

National Treasury states that Government and the National Economic Development and Labour Council have agreed to proceed with retirement reform related to the harmonisation of all retirement benefits, including provident funds. We understand this to include the implementation of the compulsory annuitisation of two-thirds of provident fund benefit payment on retirement.

This amendment to tax legislation was initially planned to come into effect in February 2016, however was subsequently postponed to 1 March 2021 to provide sufficient time for the Minister of Finance to consult interested parties, including Nedlac, and to report back to Parliament on the consultation.

The proposal requires that two thirds of a retirement benefit payable by a provident fund on retirement must be converted into an annuity, with one third being taken as cash, as is currently the case with pension funds and retirement annuity funds.

The annuitisation reform aims to ensure that people have an income in their old age and do not simply take their whole benefit as a lump sum and use it up, leading to poverty and reliance on the state for support.

National Treasury also states that Government will take steps to ensure the development of annuity products more suitable for the lower income market.

Treasury goes on to say that further reforms will include:

- "improving the oversight, and governance of, commercial umbrella funds": specific conduct requirements related to umbrella funds has been in the offing for some time and we expect to see some more definite requirements for consultation;

- "fund consolidation": - we believe this refers to the process we have seen over a number of years now where the FSCA, through various means, has been encouraging small funds that are not able to operate efficiently to consolidate or transfer into larger funds, such as umbrella funds; and

- "auto-enrolment": or mandation which refers to implementing a mandatory system of retirement savings to make it compulsory for all employers to provide a retirement fund for their employees.

Tax free savings accounts

National Treasury propose increasing the annual contribution limit to tax-free savings accounts by R3 000, from R33 000 to R36 000, on 1 March 2020.

Clarifying deductions in respect of contributions to retirement funds

Paragraphs 5(1)(a) and 6(1)(a) of the second schedule to the Income Tax Act (1962) make provision for a deduction of retirement fund contributions that did not qualify for a deduction in terms of section 11F of the act. These paragraphs refer to "own contributions", which inadvertently prevents employer retirement fund contributions on behalf of employees (made on or after 1 March 2016) from qualifying for a deduction under either paragraph.

It is proposed that the legislation be amended to fix this anomaly.

Emigration and retirement funds

Persons are currently able to withdraw funds from their pension preservation fund, provident preservation fund and retirement annuity fund upon emigrating for exchange control purposes through the Reserve Bank. As a result of the exchange control announcements in the Budget, the concept of emigration as recognised by the Reserve Bank will be phased out. Thus, Treasury is proposing that the trigger for individuals to withdraw from these funds needs be reviewed. Any resulting amendments will come into effect on 1 March 2021. We will have to wait and see what this proposal entails.

Cell captives

In December 2019, the FSCA published a position paper to address concerns about third-party cell captive insurance, in which insurance is provided through cells, rather than directly to a client. The FSCA wants to improve the regulation and supervision of cell-captives in order to protect consumers, among other things, by ensuring that a financial advisor cannot earn commission and share in the profits of the cell captive arrangement.

Health

National Health Insurance (NHI)

National Treasury states that: "Parliament is considering the National Health Insurance (NHI) Bill. Its enactment is expected to trigger large-scale reforms".

As can be seen from the Budget, Government appears to be slowing down in the short term on NHI, with a reduction in the overall health budget and allowing for rollout of NHI over a longer period of time.

National Treasury also states that a team convened by the Presidency has developed a National Quality Health Improvement Plan, which aims to improve the quality of healthcare facilities to ensure that they can be accredited for NHI.

Medical tax credits

Contrary to expectations, and after last years' freeze, there was a small increase of 2,8 per cent in medical tax credits in 2020/2021 announced in the Budget from R310 to R319 per month for the first two beneficiaries and from R209 to R215 per month for the remaining beneficiaries.

Personal Taxes

The main tax proposals include welcome personal income tax relief through above-inflation adjustments in all brackets. The personal income tax brackets and the primary, secondary and tertiary rebates will be increased by 5.2 per cent for 2020/21.

Explaining the rationale for this change, Treasury states that:

"Growth in wages, consumption and business profitability has stagnated in recent years, lowering tax receipts for personal income tax, value-added tax (VAT) and corporate income tax, which make up more than 80 per cent of total tax revenue. In this context, substantial tax increases are unlikely to be effective. South Africa already has a relatively high tax-to-GDP ratio compared with other countries at a similar level of development. New tax increases at this time could harm the economy's ability to recover. Consequently, government will not raise additional revenue from tax proposals for 2020/21".

Table 4.4 Personal income tax rates and bracket adjustments

	2019/20		2020/21
Taxable income (R)	Rates of tax	Taxable income (R)	Rates of tax
R0 - R195 850	18% of each R1	R0 - R205 900	18% of each R1
R195 851 - R305 850	R35 253 + 26% of the amount above R195 850	R205 901 - R321 600	R37 062 + 26% of the amount above R205 900
R305 851 - R423 300	R63 853 + 31% of the amount above R305 850	R321 601 - R445 100	R67 144 + 31% of the amount above R321 600
R423 301 - R555 600	R100 263 + 36% of the amount above R423 300	R445 101 - R584 200	R105 429 + 36% of the amount above R445 100
R555 601 - R708 310	R147 891 + 39% of the amount above R555 600	R584 201 - R744 800	R155 505 + 39% of the amount above R584 200
R708 311 - R1 500 000	R207 448 + 41% of the amount above R708 310	R744 801 - R1 577 300	R218 139 + 41% of the amount above R744 800
R1 500 001 and above	R532 041 + 45% of the amount above R1 500 000	R1 577 301 and above	R559 464 + 45% of the amount above R1 577 300
Rebates		**Rebates**	
Primary	R14 220	Primary	R14 958
Secondary	R7 794	Secondary	R8 199
Tertiary	R2 601	Tertiary	R2 736
Tax threshold		**Tax threshold**	
Below age 65	R79 000	Below age 65	R83 100
Age 65 and over	R122 300	Age 65 and over	R128 650
Age 75 and over	R136 750	Age 75 and over	R143 850

Source: National Treasury

In a welcome move for South African residents working offshore, the foreign earnings exemption (which was due to be capped at R1 million from 1 March 2020) will be increased to R1,25 million from 1 March 2020.

Social grants

The 2020 Budget continues with the trend to increase social grants in line with inflation:

- R80 increase for the old age, disability and care dependency grants to R1 860 per month;
- R80 increase in the war veterans grant to R 1 880;
- R40 increase for the foster care grant to R1 040 per month; and
- The child support grant will increase by R20 to R445 per month.

Government estimates it will provide access to early childhood development services to almost 700 000 children under the age of four. More than 18 million people receive a social grant in South Africa, which will be increased in the new financial year.

Minister Mboweni stated that: “Changing the way we provide social grants has generated about R1 billion per annum in efficiency savings, which will be partly used to raise the daily subsidy per child”.

Lowering the corporate tax rate

In an unexpected move, Treasury exhibited an intention to lower the corporate income tax rate. Treasury points out that, as opposed to other countries, South Africa's corporate income tax rate has remained unchanged at 28 per cent for more than a decade. India, the United States and the United Kingdom have all recently reduced their corporate income tax rates below 28 per cent. Treasury believes that reducing the corporate income tax rate will encourage businesses to invest and expand production, improve the country's competitiveness as an investment destination, and reduce the appeal of base erosion and profit shifting.

Modernising the foreign exchange system

National Treasury proposes modernising the foreign-exchange system. Since 1933, South Africa has operated a “negative list” system. Therefore, by default, foreign-currency transactions are prohibited, except for those listed in the *Currency and Exchanges Manual*. Thus, even small individual transactions (like travel) require onerous approval processes. Treasury stated that over the next 12 months, a new capital flow management system will be put in place.

All foreign-currency transactions will be allowed, except for a risk-based list of capital flow measures. This list of remaining measures include prudential limits on South African banks and institutional investors (which we assume includes retirement funds) which will remain, but the limits will be reviewed.

Fuel Levy

To adjust for inflation, the fuel levy goes up by 25 cents per litre, consisting of 16 cents for the general fuel levy and 9 cents for the Road Accident Fund levy. Despite this increase, the liabilities of the RAF are forecast to exceed R600 billion by 2022/23.

All in all, the Budget was quite surprising…

The Aloe Ferox survives and thrives when times are tough. It actually prefers less water. It wins even when it seems the odds are against it… Our economy has won before, and it will win again.

(Tito Mboweni in his 2020 Budget speech.)