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Simeka Consultants & Actuaries' Newsflash

The 2011 Budget Summary

In the 2011 budget, the Minister of Finance, Pravin Gordhan, made a number of proposals that are relevant for the employee benefits industry.

1 Changes to Tax Treatment of Retirement Fund Contributions

Taxpayers are allowed income tax deductions for contributions to pension and retirement annuity funds. In addition, employers may contribute to retirement funds on behalf of employees. Several changes to improve tax administration and promote greater equity in the income tax system are proposed.

From 1 March 2012:

- An employer's contribution on behalf of an employee will be deemed a taxable fringe benefit in the hands of the employee. Individuals will be allowed to deduct up to 22.5 per cent of their taxable income for contributions to pension, provident and retirement annuity funds.

Observation: For members of pension funds the new limit of 22.5 per cent represents a reduction from 27.5 per cent. In our experience it will only affect a small number of employees as the average contribution rate, according to the Sanlam Survey, has been in the order of 15 per cent for many years.

For members of provident funds and retirement annuity funds, this measure will bring the tax treatment of contributions on par with that of pension funds for the first time. The previous maximum contribution in respect of provident funds was 20 per cent and has therefore been elevated to 22.5 per cent. The previous maximum in respect of retirement annuities was 15 per cent.



- To ensure greater equity, two thresholds will be established, namely a minimum annual deduction of R12 000 and an annual maximum of R200 000. Members currently contributing more than R200 000 per annum will have to reconsider the tax efficiency of their current retirement contribution rate. That is especially relevant to members close to retirement who are contributing the maximum allowed under their fund.

Observation: The new minimum deduction will only affect persons who contribute 22.5 per cent and earn less than R53 333 per annum. These members will be able to contribute more than 22.5 per cent as long as this does not exceed R12 000.

The new maximum deduction of R200 000 will affect persons who contribute 22.5 per cent of pensionable earnings (PEAR), where PEAR is more than R888 888 per annum. Such persons will have to find more tax efficient retirement fund vehicles in respect of retirement planning contributions over R200 000 per annum. It remains to be seen how this would be applied in defined benefit arrangements that are in deficit.

- The base on which contributions to retirement funds and other social security taxes is calculated, will be streamlined.

To protect workers' savings, government proposes to subject lump-sum withdrawals from provident funds to the one-third limit applying to pension funds and retirement annuities. The implementation date of any changes in the rules governing provident funds will be subject to thorough consultation with trade unions and other interested parties. Vested rights however will be protected.

Observation: Based on past examples, only the lump sum which accrues after the tax amendment has been implemented will be subject to the proposed one-third limit.

2 Retirement Industry Reforms

Workers often withdraw their savings when they leave a job rather than transferring such savings to a new fund. The National Treasury will consult with the public this year regarding the viability of mandating preservation upon change of jobs or in the event of divorce.

The Pension Funds Act does not cover public sector funds. Discussions regarding the way these funds will be regulated in future are under way.

Strong supervisory capacity is also required in order to ensure that funds obey the rules. Although the number of active funds has declined significantly to about 3 200 today, the Minister feels that more consolidation is both desirable and achievable.

Pension funds also need to improve the level of disclosure to clients. A lack of transparency prevents customers from comparing products across funds which often results in excessive charges. During 2011,



the National Treasury will consult with industry bodies to draft a code of ethics and address concerns about high fees.

Observation: These issues are not new and it is interesting that measures have not been introduced in this budget to address some of them.

3 Personal Income Tax Relief

Government proposed to reduce personal income tax by R8.1 billion in order to compensate partially for inflation. Most of the relief is provided to taxpayers in lower income brackets.

Income tax brackets will be adjusted to offset the effect of bracket creep.

Income tax thresholds have been raised from R57 000 to R59 740 for below 65's and from R88 528 to R93 150 for 65's and older. For 75's and older, the threshold will be R104 261.

The interest income exemption has been raised from R22 300 to R22 800 (and from R32 000 to R33 000 for 65's and older).

The primary rebate for individuals will be increased from R10 260 to R10 755 and the secondary rebate (for 65's and older) from R5 675 to R6 012. A third rebate of R2 000 is proposed for 75's and older.

4 Tax-Free Lump Sum upon Retirement and Involuntarily Retrenchments

From 1 March 2011, the tax table with respect to retirement and death has been adjusted for inflation as follows:

Proposed Rates	Taxable Lump Sum Rate of Tax
0 - R315 000	0 per cent of amount
R315 001 - R630 000	R0 plus 18 per cent of amount exceeding R315 000
R630 001 - R945 000	R56 700 plus 27 per cent of amount exceeding R630 000
R945 001 and above	R141 750 plus 36 per cent of amount exceeding R945 000

Observation: No mention has been made of a similar adjustment in respect of the withdrawal tax table. It would appear that the government would allow these limits to reduce in line with inflation over time.



5 Medical Scheme Contributions

The deduction has increased from R670 to R720 for the member and first dependant and for each additional dependent it has increased from R410 to R440.

These deductions and qualifying out-of-pocket medical expenses will be converted to tax credits from 1 March 2011. A tax credit provides for more equitable tax relief as the relative value of the relief does not increase as the marginal tax rate of the individual increases which is currently the case.

6 Social Grants

These will increase by R60 to R1 140 from 1 April 2011. For pensioners over age of 75, the old age grant will increase by a further R20 to R1 160 per month.

Child grants will be increased from R250 to R260 per month in April 2011 and to R270 in October 2011.

7 Reforming the Means Test

Social grants' means tests are intended to ensure that support is provided to beneficiaries who need it and that social assistance is both fair and financially sustainable. Up to a certain income, the so-called "disregard level", recipients get the full grant. The grant level falls as incomes rise above the disregard level. Above the means test threshold, no grant is payable.

It is proposed that the disregard level and the means test threshold be increased substantially.

8 Enhanced Competition for Provision of Living Annuities

At present, living annuities can only be provided by long-term insurers. To encourage competition, government proposes to broaden the list of service providers allowed to provide these annuities, to include collective investment schemes and the National Treasury's retail savings bond scheme.

9 Review Tax Treatment of Risk Benefits

Government proposes that any compensation from the Road Accident Fund, whether as a lump-sum payment or an annuity, be exempted from income tax. At the same time, alignment of the tax treatment of risk benefits paid by private-sector funds will also be investigated.

Observation: This may mean that in future disability income benefits are treated in much the same way as unapproved death benefits in that contributions will be payable with after-tax income and benefits will be tax-free.



10 National Health Insurance

Proposals are under review for a national health insurance system, as part of the broader restructuring and enhancement of health services. There will be substantial cost implications. Government expects that the national health insurance system will be phased in over 14 years.

11 Tax Policy Research Projects Underway

The following research projects are currently underway:

- Taxation of financial derivatives
- Taxation of long-term insurers
- Estate duty

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