Old Mutual Corporate welcomes new draft tax implications of retirement 'two-pot' system

A move to a two-pot system, with the dual purpose of facilitating early access to one third of future contributions as well as preservation of the remainder for annuitisation at retirement, continues to be a welcome development signalling a new era for the South African retirement industry and ending old age poverty.

Source: Pixabay

This is according to Blessing Utete, managing executive of Old Mutual corporate consultants, who says that the "two-pot" system for retirement annuities, preservation funds, provident and pension funds would, in the long run, improve retirement outcomes.

Utete was speaking after the National Treasury released draft amendments to the Income Tax Act to bring into place the two-pot retirement system which was endorsed by finance minister Enoch Godongwana earlier this year.

"The new system is a monumental shift for the retirement sector. We believe it will improve long-term retirement outcomes while providing flexibility to deal with unforeseen events before retirement," says Utete.

The changes effectively mean that retirement-fund members will be able to access up to a third of their future contributions, housed in a "savings pot" designed, in the long term, to serve as an emergency fund. The remainder of the contributions will be ringfenced for retirement in the "retirement pot". Under the new legislation, members will no longer be able to access their retirement pot when changing jobs.

Launch date: March 2023

Contributions into the two-pots will only start on the effective date, which is proposed to be 1 March 2023. This means that the changes will not apply to existing savings as at that date, and there will be no seeding of the savings pot with any monies saved prior to the legislation coming into effect.

To keep costs low and discourage people from treating their retirement fund as a transactional account, the draft legislation is structured in such a way that members can only make a withdrawal from their savings pot once a year — and it must be a minimum amount of R2,000.

This provision means that cash-strapped members are unlikely to see any relief from this legislative change anytime soon, as it will take time for them to build up a meaningful amount in their savings pot. Instead, it ensures that members will be financially taken care of at retirement when they can no longer earn an income.

“As an example, if you earn R7,500 a month and your net retirement savings is (10%) R750 a month, your contribution to your savings pot would be R250 a month, with R500 going into your retirement pot. You will then be able to access the savings pot once you have saved the minimum amount of R2000,” Utete notes.

The other significant change relates to tax. Previously, if members withdrew money from retirement savings, they were taxed based on a retirement tax withdrawal table.

However, once the changes come into effect, if members make a pre-retirement withdrawal from their savings pot, their marginal tax rate will apply. So, if a member’s tax rate is 45%, the member will pay 45% tax on whatever is withdrawn from the savings pot.

This provision will mean that low-income earners who get little tax benefit on contributions will possibly pay less tax on withdrawals than is currently the case. In addition, there are also more tax-planning opportunities to try to keep costs down such as making withdrawals during periods of low or no income.

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“The tax rate is another disincentive, which has long-term benefits for members which is likely to make retirement-fund members think twice before making that withdrawal. Retirement-fund administrators will still have to apply for a tax directive, so they know how much tax to take off,” he explains.

Utete notes that, upon retirement, members will be allowed to withdraw a lump sum from their savings pot which will be subject to the retirement lumps sum tax table. This means that the first R500,000 will be tax free.

“Had the draft regulations left the savings pot to be accessed at the old retirement-fund withdrawal tax tables (sliding scale of between 18% and 36%), some would have benefited from the lower tax on accessing the savings pot if they were in an income tax bracket above the scales.

"The application of the marginal tax rate on accessing the savings pot aims to even things out and removes any tax arbitrage that could have arisen,” he said.

Awaiting final approval

“It is important to note that we have only seen a draft income tax act and explanatory note; we will need significantly more detail released before we can see how the full system will work as it will require changes to the Pension Fund Act as well,” said Utete. “The effective date of 1 March 2023 is not practical, and we would require 12 to 18 months from finalisation of the new proposals to implement the system.”

He says fund trustees will need to apply their minds to the specifics of their own fund in dealing with the two-pot system. Elements of the current draft suggest that funds will have some level of discretion on how the two-pot system will be designed at fund level.

Some aspects for consideration will therefore include the ability of administrators to manage the changes effectively, and to gauge whether there will be implications on the administration-fee structures.

The current wording of the draft regulations does introduce added complexity with potentially more choices and options for members. In addition to the increased complexity, fund members will also need to apply their minds to the appropriateness of the investment strategies for retirement savings including the new accessible savings pot.

Education is imperative

Utete notes that overall, there is as always, the need to communicate comprehensively to members about these changes.

“For example, we must emphasise that the regulations protect all existing pension-fund savings and under the current legislation this means that there is no need for members to panic and resign from their jobs to access existing funds.

"The education around accessing these funds will need to be elevated,” said Utete.