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**DRAFT EXPLANATORY MEMORANDUM**

**ON THE**

**REVENUE LAWS AMENDMENT BILL, 2024**

**1 August 2024**

TABLE OF CONTENTS

EXPLANATION OF MAIN AMENDMENTS

<b>1</b>	<b>INCOME TAX: INDIVIDUALS, SAVINGS AND EMPLOYMENT .....</b>	<b>3</b>
1.1	TWO-POTS RETIREMENT SYSTEM.....	3
<b>2</b>	<b>CLAUSE BY CLAUSE .....</b>	<b>6</b>

# 1 INCOME TAX: INDIVIDUALS, SAVINGS AND EMPLOYMENT

## 1.1 TWO-POTS RETIREMENT SYSTEM

### CLARIFICATION OF DIFFERENT ASPECTS INVOLVING TWO-POTS RETIREMENT SYSTEM

[Applicable provisions: Definitions of “legacy retirement annuity policy”, “member’s interest in the retirement component”, “member’s interest in the savings component”, “member’s interest in the vested component”, pension fund, pension preservation fund, provident fund, provident preservation fund, retirement annuity fund, retirement component, retirement interest, savings component and vested component, paragraph 2 and paragraph 6B of the Second Schedule, paragraphs 2 and 9 of the Fourth Schedule to the Income Tax Act, No. 58 of 1962 (“the Act”)]

#### I. Background

In 2023, Government proposed a further reform to the retirement saving regime to introduce the so-called “two-pots” retirement system from 1 September 2024. In terms of this reform, retirement savings will be split into a “vested component”, “savings component” and “retirement component”. In summary it is envisaged that:

- i. The “vested component” will be made up of retirement savings on 31 August 2024. It was proposed that the regime makes provision for the creation of once-off seed capital, calculated as ten per cent of the “vested component” or R30 000, whichever is the lowest, to be allocated from the retirement savings to the new “savings component”.
- ii. From 1 September 2024:
  - a. retirement contributions will be split into two, with one-third of the contributions going to the “savings component” and two-thirds going to the “retirement component”;
  - b. members will be able to withdraw funds allocated to the “savings component” once every tax year should they need to, for example, in the case of financial distress or emergency. The minimum withdrawal amount is R2 000 and will be taxed at marginal income tax rates.
  - c. The two-thirds which will be allocated to the “retirement component” will be required to be preserved until retirement (i.e. withdrawals from this component will be triggered by the member reaching normal retirement age per the fund rules).

The 2023 amendments to the retirement saving regime proposed the introduction of tax-free transfers between components as well as the introduction of paragraph 6B of the Second Schedule to the Act, dealing with these transfers wherein, members are allowed to make intra-fund transfers at any time and these transfers will be treated as tax-free transfers and be subject to the fund obtaining a tax directive.

The 2023 amendments allow for section 37D deductions, as outlined in the Pension Funds Act of 1956, against the savings, vested, and retirement components. However, it is worth noting that while section 37D deductions are typically taxed under paragraph 2(1)(b) of the Second Schedule to the Act, except for maintenance awards ordered by a court under the Maintenance Act of 1998 which are taxed under section 7(11) of the Act.

In general, when formal emigration through the South African Reserve Bank (SARB) was phased out effective 1 March 2021, it was replaced with the process of ceasing to be a tax resident of South Africa. This meant a change in the trigger event for these types of withdrawals from pension preservation funds, provident preservation funds and retirement annuity funds. Where the trigger event for early withdrawal from these funds used to be changing your status from resident to non-resident from an exchange control perspective, it is now triggered by changing your status to non-resident from a tax perspective. This is because the rule states that to access a withdrawal benefit before retirement from a pension preservation fund, provident preservation fund or retirement annuity fund, a taxpayer may no longer follow the formal emigration process with the Reserve Bank, but a taxpayer must have been a non-resident for South African tax purposes for an uninterrupted period of at least three years.

However, the 2023 amendments went further and incorrectly required members of pension funds to be subjected to this rule in the vested component.

## **II. Reasons for change**

The reasons for change stems from:

- a. Despite the changes made in 2023 to enhance the two-pot regime, it has become apparent that further adjustments are necessary to clarify the existing language. For instance, there is a need to explicitly exclude maintenance awards, which are taxed under section 7(11) of the Act, from the three components mentioned above.
- b. In order to simplify the directives system for both administrators and SARS, and to cater for speedy implementation of this reform, the requirement to obtain a directive when transferring the seeding amount from the “vested component” to the “savings component” is not necessary as tax is only imposed on withdrawal from the “savings component”.
- c. As mentioned above, the cease to be resident requirements should remain applicable to preservation funds and retirement annuity funds and to the retirement components of pension and provident funds. The savings component is excluded because it can be accessed at any time prior to retirement.
- d. Consequential amendments are needed to cater for an exclusion of the “savings withdrawal benefit” from a liability for the Skills Development Levy payable and Unemployment Insurance Contributions payable by members.

## **III. Proposal**

*A. Technical considerations with respect to section 37D deductions as outlined in the Pension Funds Act:*

It is proposed that:

- various drafting changes be implemented to enhance clarity and precision in the wording to ensure that amounts that are allowed to be deducted from a benefit, in accordance with section 37D (1)(a), (b), (c) or (d)(i) of the Pension Funds Act, are proportionally deducted from each component. The sum of these amounts deducted from each component is deemed to be a lump sum benefit contemplated in paragraph 2(1)(b) of the Second Schedule to the Act. Therefore, this proposal will apply to all three components that is, ‘member’s interest in the retirement component’, ‘member’s interest in the savings

component' and 'member's interest in the vested component'. Please see consequential amendment in the 2024 Draft Taxation Laws Amendment Bill relating to the alignment of the Income Tax Act with amendments made by Pension Funds Amendment Act, 2024 ( Act 31 of 2024) as section 37D(1)(d)(iB) of the Pension Funds Amendment Act refers to interim maintenance orders granted by the court in terms of rule 43 of the High Court rules or rule 58 of the Magistrates' Court rules made under section 6 of the Rules Board for Courts of Law Act, 1985 ( Act No.1 of 1985

*B. Changes concerning emigration and ceasing to be a resident of South Africa:*

It is proposed that the policy intent be clarified such that to ensure that the cease to be resident requirements apply to all retirement funds except for the vested components of the pension and provident funds and to all savings components.

As it is longer than 3 and a half years since the cut-off date for the transitional rule for the Reserve Bank emigration process, it is proposed that all transitional rules be removed from the definitions of retirement funds.

*C. Intra-fund transfers and directives*

It is proposed that in order to simplify the directives system for both administrators and SARS for speedy implementation, the requirement to obtain a tax directive when transferring the seeding amount from the 'vested component' to the 'savings component' be done away with. A directive is not strictly necessary at this point, as tax is only imposed on withdrawal from the savings component.

In addition, it is proposed that reallocations of amounts between the three components within the same fund is not treated as transfers for income tax purposes and that the requirement to obtain a directive for reallocations between the three components within the same fund be withdrawn.

*D. Skills Development Levy and Unemployment Insurance Contributions*

It is proposed that consequential amendments be made to these Acts.

**IV. Effective date**

The proposed amendments will come into effect on 1 September 2024.

## 2 CLAUSE BY CLAUSE

### CLAUSE 1

Income Tax Act: Amendments to section 1(1)

Sub-clause (a): The amendment seeks give clarity that the conditions are contained in an official notice by the Financial Sector Conduct Authority and confirms that the exemption is applicable on a policy level and not fund level.

Sub-clause (b): see notes on **CLARIFICATION OF DIFFERENT ASPECTS INVOLVING TWO-POTS RETIREMENT SYSTEM**

Sub-clause (c): The amendment seeks to replace the reference to employee with member to cater for paid-up members who are not employees.

In addition, in the Published Bill on 21 February 2024, the words: “in the definition of “savings withdrawal benefit” was deleted as it was read to already be included in the purpose of the fund. However, the reference to savings withdrawal benefit should not be deleted because the main purpose of a pension fund is to provide annuities to employees on retirement. Any deviation from the main purpose represents extraordinary payments to retirement fund members, and must be catered for in the definition, much like the reference to paragraph 2C of the Second Schedule (past surplus payments as per section 15B of the Pension Funds Act and bulking payments) or section 15A or 15E of the Pension Funds Act (future surplus payments). Therefore, a similar reference to the payment of the savings withdrawal benefit must be catered for in the definition of a pension fund to extend the purpose of a pension fund, and therefore to provide for the payment of this extraordinary amount.

Sub-clause (d): The amendment seeks to ensure that given that the term “retirement interest” is a defined term that refers to all the components and this was not the intent of the provision. Therefore, this provision should rather refer to defined terms “members’ interest in the vested component” and “member’s interest in the retirement component” as it defines the breakdown within each component. The reference to “retirement interest” in respect of transfers done in terms of paragraph 2(1)(c) of the Second Schedule remains unchanged because, in respect of those transfers, all components in the fund must be transferred to the other fund.

Sub-clause (e): The amendment seeks to replace the reference to employee with member to cater for paid-up members who are no longer employed by a participating employer and see notes on **CLARIFICATION OF DIFFERENT ASPECTS INVOLVING TWO-POTS RETIREMENT SYSTEM.**

Sub-clause (f): The amendment is a technical correction which seeks to inset the word “this” and “a” to ensure grammatical correctness.

Sub-clause (g): The amendment seeks to align the wording with that of paragraph 2(1)(c) of the Second Schedule.

Sub-clause (h): The amendment is a technical correction which seeks to delete the word ‘have’ and to inset the word “this” to ensure grammatical correctness.

Sub-clause (i): The amendment seeks to clarify that all three components of a contract must be transferred together to the pension preservation fund.

Sub-clause (j): The amendment seeks to clarify that with effect from the implementation date, members of preservation funds will still be allowed to take their one withdrawal from the “new” vested component per transfer received or per contract if they have not already done so, or per vested component transferred in. This amendment was unintentionally overlooked in the Published Bill on 21 February 2024.

Sub-clause (k): The amendment seeks to align paragraph (aa) with the provisions relating to pension preservation funds in relation to amounts payable as a result of the member ceasing to be a resident in that an amount from the retirement component and vested component is deemed to be paid as a lump sum benefit contemplated in paragraph 2(1)(b)(ii) and the amendment deleted sub-item (a) because previous emigration withdrawal provisions would only apply to the vested component and never to the retirement component. In addition, the amendment also seeks to clarify that paragraph (bb) applies to a payment from the vested component in circumstances where the member has already received his/her once-off withdrawal and see notes further on **CLARIFICATION OF DIFFERENT ASPECTS INVOLVING TWO-POTS RETIREMENT SYSTEM.**

Sub-clause (l): The amendment seeks to clarify that a member who has transferred a retirement interest in terms of paragraph 2(1)(c) of the Second Schedule to this fund shall not be entitled to access the amount transferred as a withdrawal benefit from the vested component. In addition, the amendment seeks to delete the reference to ‘savings withdrawal benefit’ because this paragraph now only deals with withdrawal benefits from the vested component and the reference to a savings withdrawal benefit is not correct.

Sub-clause (m): The amendment seeks to replace the reference to employee with member and to amend the introductory wording to the proviso as it was omitted in the previous substitution, making the reference to members who were members of a provident fund or provident preservation fund and was younger or older than 55 on 1 March 2021 non-sensical. Therefore, the inclusion of the wording in the proviso ensures that these vested benefits for these members remain excluded from the calculation that determines what portion of the benefit, if any, will be subject to compulsory annuitisation on retirement.

Sub-clause (n): The amendment seeks to correct that the further proviso is being substituted instead of being ‘added’ and to be consistent with clauses 1(1)(q), 1(1)(z) and 1(1)(zD) by removing the inverted commas in the definitions of savings component, retirement component and vested component.

Sub-clause (o): The amendment seeks to substitute the amendment made in the Revenue Laws Amendment Act by replacing the word ‘benefits’ with ‘annuities’ because the main purpose was aligned with that of a pension fund with the introduction of compulsory annuitization, with effect from 1 March 2021. In addition, on death of the member the beneficiaries are entitled to take the full amount in cash or partly and as an annuity. Therefore, it should be ‘benefits’ and not ‘annuities’ for dependants. Lastly, the amendment seeks to correct the wording as it now reads as providing annuities for deceased employees twice, which is unnecessary.

Sub-clause (p): The amendment seeks to replace the reference to employee with member to cater for paid-up members who are not employees. Also, the amendment seeks to clarify that the inclusion of all three components by referring to the defined term “retirement interest” was not the intent in this provision. Therefore, this provision should rather refer to defined terms “members’ interest in the vested component” and “member’s interest in the retirement component” as it defines the breakdown within each component. The reference to “retirement interest” in respect of transfers done in terms of paragraph 2(1)(c) of the Second Schedule remains unchanged

because, in respect of those transfers, all components in the provident fund must be transferred to the other fund.

Sub-clause (q): The amendment seeks to remove the inverted commas in the definitions of savings component, retirement component and vested component. Sub-clause (ii) relates to public sector funds and clarifies that the compulsory annuitisation requirement is applicable to these funds and confirms that the value of the vested benefit, relating to members who were members of a provident fund or provident preservation fund on 1 March 2021, will remain excluded from the calculation that determines what portion of the benefits if any, will be subject to compulsory annuitisation on retirement. Also see notes on **CLARIFICATION OF DIFFERENT ASPECTS INVOLVING TWO-POTS RETIREMENT SYSTEM.**

Sub-clause (r): The amendment seeks to correct the omission of a reference to the vested component in the provident preservation fund.

Sub-clause (s): The amendment seeks to correct the reference given that the substitution is made to the definition of “provident preservation fund”. In addition, the amendment seeks to correct the omission of a reference to the vested component in the provident preservation fund.

Sub-clause (t): The amendment seeks to correct the omission of a reference to the vested component in the provident preservation fund.

Sub-clause (u): The amendment seeks to clarify that all three components of a contract must be transferred together to the provident preservation fund.

Sub-clause (v): The amendment seeks to clarify that with effect from the implementation date, members of provident preservation funds will still be allowed to take their one withdrawal from the “new” vested components per transfer received or per contract, if they have not already done so, or per vested component transferred in. This amendment was unintentionally overlooked in the Published Bill on 21 February 2024.

Sub-clause (w): The amendment seeks to align paragraph (aa) with the provisions relating to provident preservation funds in relation to amounts payable as a result of the member ceasing to be a resident in that an amount from the retirement component and the vested component is deemed to be paid as a lumpsum benefit contemplated in paragraph 2(1)(b)(ii). The amendment deleted sub-item (a) because previous emigration withdrawal provisions would only apply to the vested component and never to the retirement component. The amendment also seeks to clarify that paragraph (bb) only applies to a payment from the vested component in circumstances where the member has already received his/her once-off withdrawal. For notes thereon and the deletion of the emigration withdrawal provision see **CLARIFICATION OF DIFFERENT ASPECTS INVOLVING TWO-POTS RETIREMENT SYSTEM.**

Sub-clause (x): The amendment seeks to clarify that a member who has transferred a retirement interest in terms of paragraph 2(1)(c) of the Second Schedule to this fund shall not be entitled to payment of a withdrawal benefit from the vested component.

Sub-clause (y): The amendment seeks to delete the reference to the vested component as it does not exist before 1 March 2025, thus, the wording cannot refer to the vested component prior to that date. In addition, the amendment now refers to the value of the member's interest in the vested component and to ensure that the portion of the vested component that relates to the value of the vested benefits for members who were members of a provident fund or provident



preservation fund on 1 March 2021 remains excluded from the compulsory annuitisation on retirement.

Sub-clause (z): The amendment seeks to correct that the further proviso is being substituted instead of being 'added' and to be consistent with clauses 1(1)(q), 1(1)(z) and 1(1)(zD) by removing the inverted commas in the definitions of savings component, retirement component and vested component.

Sub-clause (zA): The amendment seeks to replace the words 'contemplated in the savings withdrawal benefit in section 1' with 'savings withdrawal benefit' to clarify that the main purpose of a retirement annuity fund of providing annuities is extended to cater for the payment of savings withdrawal benefits.

Sub-clause (zB): The amendment seeks to replace the reference to employee with member to cater for paid-up members who are not employees.

Sub-clause (zC): The amendment seeks to align paragraph (A) with the provisions relating to retirement annuity fund in relation to retirement component such that an amount from the retirement component is deemed to be paid as a lumpsum benefit contemplated in paragraph 2(1)(b)(ii). In addition, the amendment deleted sub-item (AA) because previous emigration withdrawal provisions would only apply to vested component and never to retirement component. The amendment also seeks to clarify that paragraph (B) only applies to a payment from the vested component in circumstances where the member has already received his/her once-off withdrawal. Lastly, the amendment seeks to remove paragraph (C) which contained duplicate provisions. Refer to **CLARIFICATION OF DIFFERENT ASPECTS INVOLVING TWO-POTS RETIREMENT SYSTEM** for in respect of the deletion of the emigration withdrawal provision.

Sub-clause (zD): The amendment seeks to correct that the further proviso is being substituted instead of being 'added' and to be consistent with clauses 1(1)(q), 1(1)(z) and 1(1)(zD) by removing the inverted commas in the definitions of savings component, retirement component and vested component.

Sub-clause (zE): The amendment seeks to ensure that there is consistent use of terms in the definition of the "legacy retirement annuity policy", "savings component" and "retirement component". The amendment also seeks to clarify that a member of a provident fund who was over the age of 55 years on 1 March 2021 and remained a member of that fund will continue to contribute to the vested component unless the member elected to contribute to the retirement component within 12 months of 1 September 2024.

Sub-clause (zF): The amendment seeks (i) to clarify in paragraph (a) how the calculation of the seeding amount is done and states that it is limited to a monetary amount and that this monetary amount applies per fund or per contract in the case of preservation funds or retirement annuity funds. It should be noted that the value of the seeding, as determined on 31 August 2024, in respect of members who were 55 years or older and members of a provident fund on 1 March 2021 and remained members of that fund, but is then transferred to another fund, must be allocated by the receiving fund to the savings component.

In addition, the amendment seeks to (ii) remove the reference to vested component as the vested component does not exist prior to 1 September 2024, (iii) to amend subparagraph (a)(ii) to include the value of contributions received and fund returns on those contributions after 1 March 2021, (iv) replace the words 'similar component' to 'savings component'; (v) to delete the words 'former members' as they are obsolete and (vi) to amend the reference to both death and retirement as

both are retirement fund lump sum benefits for income tax purposes. Lastly, (vii) the amendment seeks to clarify that on death or retirement of the member, the member's interest in the savings component may on election be paid as a retirement fund lump sum benefit in cash and clarifying that any portion of the savings component that is not taken as lumpsum will be added to the retirement component for the purpose of providing or purchasing an annuity. Any portion of the savings component taken as a lump sum in cash on retirement will be excluded from the calculation to determine what portion of the benefit, if any, will be subject to compulsory annuitisation but will be subject to the aggregation principle in that previous lump sums will be taken into account when determining the tax amount payable on the current lump sum benefit payable. Lastly, (viii) the amendment seeks to clarify when seeding must take place for members who were over the age of 55 on 1 March 2021 and remains a member of the fund. As previously stated, the value of the seeding, as determined on 31 August 2024, in respect of members who were 55 years or older and members of a provident fund on 1 March 2021 and remained members of that fund, but is then transferred to another fund, must be allocated by the receiving fund to the savings component.

Sub-clause (zG): The amendment seeks to clarify that members who were 55 years or older and members of a provident fund on 1 March 2021 and remained members of that fund will contribute to the vested component unless they make an election to be part of the two-pots retirement system. If these members transfer within the 12 month-period but have not made an election, any contributions made by these members up to the date of transfer will be allocated to the vested component. Any contributions made to the new fund will be allocated to the member's savings component and retirement component.

## **CLAUSE 2**

Income Tax Act: Amendment to paragraph 2 of the Second Schedule to the Act

See notes on **CLARIFICATION OF DIFFERENT ASPECTS INVOLVING TWO-POTS RETIREMENT SYSTEM.**

## **CLAUSE 3**

Income Tax Act: Amendment to paragraph 6B of the Second Schedule to the Act

See notes on **CLARIFICATION OF DIFFERENT ASPECTS INVOLVING TWO-POTS RETIREMENT SYSTEM.**

## **CLAUSE 4**

Income Tax Act: Amendment to paragraph 2 of the Fourth Schedule to the Act

The amendment seeks to allow for a rate of tax to be provided by SARS for administrators to withhold tax on savings withdrawal benefits.

## CLAUSE 5

Income Tax Act: Income Tax Act: Amendment to paragraph 9 of the Fourth Schedule to the Act

The amendment seeks to correct grammatical changes subsequent to the amendment that requires an employer to ascertain the amount of employees' tax to be withheld from savings withdrawal benefit by reference to paragraph (eD) of the definition of gross income.

## CLAUSE 6

Skills Development Levies Act: Amendment to section 3 of the Act Skills Development Levies Act

See notes on **CLARIFICATION OF DIFFERENT ASPECTS INVOLVING TWO-POTS RETIREMENT SYSTEM.**

## CLAUSE 7

Unemployment Insurance Contributions Act: Amendment to section 1 of the Act Unemployment Insurance Contributions Act

See notes on **CLARIFICATION OF DIFFERENT ASPECTS INVOLVING TWO-POTS RETIREMENT SYSTEM.**

## CLAUSE 8

Short title