30 April 2014

Mr Chris Axelson
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BY E-MAIL: savings.incentive@treasury.gov.za

Dear Mr Axelson

RE: CALL FOR COMMENT: NON-RETIREMENT SAVINGS: TAX FREE SAVINGS ACCOUNT

Thank you for the opportunity to contribute to and provide commentary on the principles, allowable savings and investment products, as well as the two options to deal with non-compliance to the annual contribution limit contained in the response document published on 14 March 2014 regarding the proposed non-retirement savings, tax free savings accounts announced in the 2014 Budget Review.

Set out below, please find the consolidated commentary developed from both an internal review of the provisions as well as from consultations with stakeholders and industry. The commentary reflects the collective view of stakeholders and industry role players consulted with.

1 INTRODUCTION

The South African economy today is still fragile due to the distorted pattern of ownership and economic exclusion created by apartheid policies. In relation to South Africa's National Development Plan ('NDP'), and an analysis of the problem identified by the National Planning Commission ('NPC'), we agree with the position that it is a concern that South Africa is in a low growth, middle income trap. According to the NDP there are four key features of this trap that serve to reinforce each other. These are low levels of competition for goods and services, large numbers of work seekers who cannot enter the labour market, low savings and a poor skills profile. It is also a concern that much of our domestic consumption is financed with debt and many households are falling behind on their debt payments. This is not a sustainable position for our people.

It is therefore no surprise that research done by the World Bank found that few South Africans retire with enough savings to support themselves. Furthermore, the South African Savings Institute reported that South African households saved only 1.7% of the GDP in 2012, compared to the Chinese who save 22% of their GDP. In China, household savings account for 51% of their total savings whereas in South Africa, household savings account for just 15% of the total savings. This is significantly lower than the target set by the NDP to increase savings to 25% of GDP by 2030.

It is therefore evident that something needs to be done to change the way South Africans manage their money. The introduction of the tax free savings account incentive by the National Treasury is therefore most welcomed and can definitely be regarded as a step in the right direction. We believe that this incentive will facilitate an increase in the national savings to achieve our target by 2030.

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2 EROSION OF INTEREST INCOME EXEMPTION

Problem statement

It must be noted that the decision to retain (and not abolish) the current interest tax exemptions for individuals (R23 800 for individuals below 65 years of age, and R34 500 for those 65 years or older) is most welcome. We acknowledge that although these limits will not increase in value and will erode over time due to inflation, these individuals will have the new tax free savings proposals to utilise in addition to these exemption limits. Despite this welcomed relief, due to the fact that pensions paid to the elderly do not keep up with inflation encountered in the marketplace many retired taxpayers are forced to supplement their pensions by using their nest-egg savings as an additional income stream. When initially planning their investments, the annual interest tax exemptions were taken into account. The suitability of pensioners current interest earning products as well as new potential investments that they will be required to make, will need to be considered carefully by them and advice in this regard will need to be obtained.

Proposed recommendation

Although we acknowledge that pensioners are in different stages of financial wellbeing in their retirement, a large portion of pensioners rely on their savings for their increased living expenses. Consideration could perhaps be given to exempting income tax on all savings for taxpayers 65 years of age or older (that is no limit should apply to them) in order to provide relief to these taxpayers so as to lessen the risk that these taxpayers become dependent on the government for basic services like hospitalisation and grants. Individuals younger than 65 will on the other hand be encouraged to save from an early age for their retirement savings. This proposal is in line with the key objectives of the savings proposal that is to reduce the vulnerability of households.

3 ANNUAL AND LIFETIME LIMITATIONS

Problem statement

The annual limit is a common characteristic of tax incentivised savings accounts in countries like Canada, Ireland and the United Kingdom and is meant to encourage savings in the short term, for future benefit. It is debatable whether these first world countries should be used as indicators applicable to South Africa, a developing country. We do recognise that these limits are based on affordability conditions and it will be interesting to see if these limits will achieve the desired results in savings behaviour.

Recommendation

The comparable for developing countries such as Brazil and Malaysia that have gross domestic savings of 30% and 37.6% respectively as a % of GDP should perhaps be considered should the desired levels of savings not be achieved the new tax free savings accounts. For instance, interest income earned from local bank accounts in both these countries is completely tax exempt.

4 TREATMENT OF WITHDRAWALS

Problem statement

The withdrawals of accumulated savings cannot be replaced and any contributions will be subject to the annual and lifetime limits. This design feature attempts to discourage individuals to use these savings for impulse purchases. No special dispensation is available to withdraw amounts for an emergency. These circumstances are specifically applicable amongst the low and medium income earning categories in South Africa who do not necessarily have additional savings to use for emergencies and are dependent on government for basic services.

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Recommendation

Although we understand that providing any explicit special dispensation for emergency withdrawals would be excessively complex, we propose that the withdrawal restrictions should not be applicable to the lower income earning categories (those below the tax threshold perhaps) because as stated clearly in the proposal published these households are more than likely to make use of any (if they do indeed have savings) savings available for emergency purposes. It is proposed that the restrictions on withdrawal of funds and the replacement thereof only be made applicable to the higher income taxpayers.

5 CRITETIA FOR SAVINGS AND INVESTMENT PRODUCTS TO BE INCLUDED

Problem statement

The FSB will monitor service providers to ensure the product parameters are adhered to. In extreme cases of market misconduct, the eligibility of the account may be cancelled altogether. The proposals are unclear as to what the impact from a tax perspective will be on the transfer of funds from a cancelled account to an approved account - will they be subject to the withdrawal rules or will they be specifically excluded?

Recommendation

The final proposals should specifically state that where a product has been cancelled due to misconduct the investor will be able to transfer the savings to an eligible product without incurring any cancellation costs or alternatively be subject to the withdrawal rules applicable.

6 REPORTING REQUIREMENTS

Problem statement

Both service providers and taxpayers who make use of the tax free accounts will be required to provide information to SARS in the prescribed returns. SARS will also be responsible to consolidate all the annual information to check the annual limits are not exceeded and to provide anonymised information on the usage of the account to National Treasury in order to monitor and evaluate the progress of the incentive against the stated objectives. In order to obtain the tax free savings benefits, investors have to be registered as a taxpayer at SARS and are required to submit a tax return. Specially taking into account the objective to keep the type of products simple in order to attract a greater number of individuals to save, particularly for those who struggle with financial literacy, this might be an onerous requirement as certain of these individuals might not currently be submitting a tax return as they earn below the tax threshold and do not receive interest income above the interest exemption thresholds.

Recommendation

It is suggested that an exemption for submission of a tax return be made for these individuals using the tax free savings accounts as the information will already be in the possession of SARS via the various banks etc. Alternatively, a simplified return must be made available both electronically and manually for these individuals to complete so as to minimise their compliance costs.

7 CONTRIBUTIONS THAT ARE OVER THE LIMIT

Problem statement

SARS will consolidate all the annual information to check that the investors adhered to the annual limits. Taxpayers will be responsible for managing their overall annual contributions to remain within the prevailing limit. This makes sense as income tax is regarded as a self-assessment tax. Each service provider will also endeavour to ensure that taxpayers adhere to the prevailing limit in

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the accounts they manage. Currently, National Treasury is considering two options to deal with contributions over the limits - namely, effecting a complete reversal where the over contributions are withdrawn and the tax to be paid is corrected, or alternatively, where the general tax rules would apply to the over contributions in order to minimise the administrative burden. The first option is administratively burdensome for SARS and the service providers, the second option is much simpler for these entities but for the investors it could mean that their tax charge is higher than if the returns on the over contributions were generated outside the account.

A further concern, is that it is not clear what the consequences will be if the investor makes additional contributions into a separate account with another service provider despite the signing of the disclaimer to the contrary. No penalties or sanctions for this behaviour have been considered in the discussion document.

Recommendation

As the overall purpose of these tax free savings accounts is to increase savings, it is submitted that limiting persons wishing to contribute more to these savings accounts should not be prevented. However, should an increase in contributions to these accounts result in additional tax and compliance costs, then this suggestion does not become feasible. SAIT is therefore of the opinion that the purest option in dealing with contributions in excess of the annual limit is to reverse the process completely by withdrawing both the excess contributions and the growth on those contributions from the time they were deposited into the account. The rectification of the tax payments should, however, be dealt with by SARS as it is impractical for the service provider to determine the amount of tax outstanding due to the fact that the marginal tax rate of the investor is not available to them. We recommend that the service provider must re-submit the information after the reversal process and SARS must be responsible to ensure the correct tax treatment thereof. An additional disincentive of the excess is to disallow the investment interest exemption currently still available for this portion of the investment income.

Even though the general tax rule option is a simpler option, the additional administrative requirements of offering the accounts and increase in compliance costs is not in line with the objectives of the savings mechanism proposed i.e. to promote household savings. The administrative costs for these products must be kept at the lowest level possible.

8 OTHER

The proposed tax free savings accounts will be tax-free in the hands of the individual, regardless of whether it is dividends, capital gains or interest received. These savings accounts will be even more attractive for investors and promote an increase in household savings if the estate duty exemption is also considered upon the death of the investor.

Overall, we commend the National Treasury on the introduction of these tax free savings accounts as we do believe that it will help improve the savings culture in South Africa. We look forward to seeing the draft legislation.

Yours sincerely,

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