Two-pot retirement system summary

National Treasury received several proposals to enable limited pre-retirement withdrawals from retirement funds. They have agreed to consider legislative amendments to take effect on 1 March 2024, to allow for limited pre-retirement withdrawals under certain circumstances, while also implementing legislation that will make it harder for members to encash their pension benefits when they change jobs. Limited withdrawals will therefore be allowed, but it will be linked to changes providing for members to preserve their retirement benefits on leaving employment and withdrawal from the fund. This system is called the two-pot system.

The key proposals to move towards the two-pot retirement system, was first published by National Treasury in the draft Revenue Laws Amendment Bill (RLAB) on 29 July 2022. The second draft of the RLAB was issued on 9 June 2023. Proposed consequential amendments to the Pension Funds Act, to cater for the two-pot system, was also released through the draft Revenue Administration and Pension Laws Amendment Bill. The final RLAB was published on 1 November 2023, wherein it was proposed that the implementation date of the two-pot retirement system be 1 March 2025.

The SCoF (Standing Committee on Finance) hearing in Parliament to discuss and approve the RLAB was held on 21 November 2023. The uniform agreement was that the implementation date of the two-pot retirement system must be **1 March 2024**. The SCoF report will now have to be considered by the National Assembly in Parliament for promulgation of the RLAB.

Comment: *When a Parliamentary committee changes a proposed law, they are required to provide the Minister of Finance with an opportunity to respond thereto. Once received, the Standing Committee on Finance will consider his response and make their final decision regarding the implementation date. National Assembly will then vote on the final amendment bill as tabled by the Standing Committee on Finance.*

The final Revenue Administration and Pension Laws Amendment Bill (RAPLAB), making provision for changes to the Pension Funds Act, has however not been published yet.

The two-pot retirement system will be applicable to pension funds, provident funds, preservation funds, and retirement annuity funds. Legacy retirement annuity policies entered into before 1 January 2022, beneficiary funds, and unclaimed benefit funds will be exempt from the two-pot retirement system.

The word "pot" was replaced with "component" in the RLAB. The system will continue to be referred to as the two-pot retirement system, and for the purposes of this document, the word "pot" is used.

- **Funding of the pots**

Three new pots are created in practice for members who were members of a retirement fund prior to 1 March 2024, namely a vested pot, a retirement pot, and a savings pot.

The vested pot will consist of the value of a member's benefit in their retirement fund immediately prior to 1 March 2024 (less the opening balance allocated to the savings pot for seeding purposes). The current tax regime will remain applicable to this pot, which means that the vested pot will be taxed according to the respective retirement and withdrawal tables.

For members with annuitisation vested rights, the vested pot will consist of such annuitisation date vested rights, plus the non-vested rights since annuitisation date.

Comment: *Annuitisation of retirement benefits was implemented in provident funds with effect from 1 March 2021. The effective date is referred to as "annuitisation date" in the retirement fund industry. The main difference brought about at annuitisation date was that provident fund members now also have to be provided with a pension (annuity) at retirement – similar to pension funds. Vested rights as at annuitisation date are protected, meaning that the benefit a member had in a provident fund when annuitisation was introduced, will still be treated in terms of the previous provisions applicable to provident funds, hence reference is made to 'annuitisation date vested rights". The only exception to the annuitisation rule was in respect of provident fund members aged 55 and older as at 1 March 2021, who retained the option to take their full benefit in cash at retirement. It should be noted that annuitisation date vested benefits may also have bearing on pension funds as a provident fund member may have transferred to a pension fund, resulting in the annuitisation date vested benefit also being transferred.*

No further contributions can be made to the vested pot, except for members of provident funds who were 55 years or older on 1 March 2021 and who are still members of the same provident fund and have not elected to participate in the two-pot system. These members will be able to contribute to the vested pot in terms of the pre-annuitisation regime until they either leave the provident fund or retire. This means that for those members, neither annuitisation nor the two-pot system will apply, but they will lose the right to continue to contribute to the vested pot when they exit the provident fund that they were members of on 1 March 2021.

The retirement pot and savings pot will accumulate with all new contributions from 1 March 2024. One-third of new contributions will be directed to the savings pot, with two-thirds directed to the retirement pot.

Comment: *The tax deductibility of contributions remains the same, i.e. up to 27.5% or R350 000 per annum of the total contributions to the fund, is tax deductible. Contributions in excess of the tax-deductible amount, will also be split one-third to the savings pot and two-thirds to the retirement pot. At retirement those excess contributions above the tax-deductible threshold may then be set off from a lump sum taken from the savings pot, or from the annuity amount payable from the retirement pot.*

The opening balance of each member's savings pot on 1 March 2024 will be 10% of a member's value in a fund, but not more than R30 000.

Comment: *The opening balance (seed amount) will be allocated from the vested pot. The Income Tax Act makes provision for the proportional reduction of the annuitisation vested and non-vested portions.*

In respect of defined benefit funds, it is proposed that the calculation of the one-third contribution to the savings pot be based on one-third of the increase in the member's pensionable service. The two-thirds contribution to the retirement pot will likewise be calculated based on two-thirds of the increase in the member's pensionable service with effect from 1 March 2024. The opening balance must be calculated in the same manner and can be accommodated with a past service adjustment.

Defined benefit funds that are unable to apply the reduction of pensionable service basis, will be allowed to use an alternative method of calculating the value of the two-pot system contribution split. The application of this alternative method should be fair and equitable and will be subject to approval by the Financial Sector Conduct Authority to ensure financial and actuarial soundness.

- **Payment from the pots**

Amounts contributed to the retirement pot will be subject to compulsory preservation and cannot be accessed before retirement. At retirement, the total value in the retirement pot must be paid in the form of an annuity, except if it, together with the portion from the vested pot that must be taken as a pension, does not exceed the de minimis amount (currently R165 000).

Amounts contributed to the savings pot can be accessed at any time before retirement, but only one withdrawal can be made during any tax year (1 March to the end of February of the following year), including for members who left employment. The minimum withdrawal amount is proposed as being R2 000, before any charges/transaction costs are deducted. When a member leaves employment, an additional withdrawal will be allowed in the same tax year if the amount in the savings pot is less than R2 000.

To discourage unnecessary early withdrawals, withdrawals from the savings pot before retirement will be included in the member's gross income for that tax year and the withdrawal tax table will not apply to withdrawals from the savings pot. This means that the person's marginal tax rate will be applied to the amount withdrawn, in other words it will be treated the same as remuneration and be subject to employees' tax (PAYE).

Comment: *The RLAB suggests that a form of tax directive system will be applied to withdrawals from the savings pot (taxed at marginal rates and not in accordance with retirement fund tax tables). This will require development by SARS, and at this point it is not clear what the process will entail.*

When a member leaves employment before retirement, the amount in the vested pot may be taken in cash. The withdrawal tax table will still apply to permissible withdrawals from the vested pot.

At retirement, the amount in the vested pot will be payable as a lump sum, a monthly pension or a combination, depending on annuitisation rules and whether from a pension or provident fund.

Where the member opts to withdraw funds from the savings pot as a lump sum on retirement, it will be taxable as a retirement lump sum benefit subject to the retirement lump sum tax table.

Any funds available in the savings pot at retirement or death can either be withdrawn in full or transferred tax-free to the retirement pot.

Any funds available in the retirement pot on death can either be paid in cash or in the form of an annuity. Where it is paid as a lump sum, it will be taxable in accordance with the retirement lump sum table.

If a member ceases to be a tax resident for a period of at least three years, full withdrawals from the retirement pot can take place before the retirement date, similar to the current emigration rule for preservation and retirement annuity funds. In this instance, the retirement pot will be taxed in accordance with the lump sum withdrawal tax tables. Amounts in the savings pot will remain accessible and will be included in the member's gross income (taxed at marginal rate).

Comment: *In the current form of the RLAB, provision is also made for withdrawals from the vested pot if a member ceases to be a tax resident for a period of at least three years. This is presumably to cater for deferred retirees (members who have retired from employment, but who have not elected yet to receive the retirement benefit from the fund) to be able to withdraw from the vested pot upon ceasing to be a tax resident.*

Withdrawals from the retirement pot if a member is retrenched and has no alternative source of income will be considered in the second phase of implementation of the two-pot system. National Treasury indicated that further complementary measures may be considered in the second phase, to ensure that the primary objectives for saving for retirement is not compromised and to protect the liquidity of funds at all stages.

Section 37D deductions will be permissible and made proportionally across all three pots. Those deductions will still be taxed in accordance with the retirement withdrawal tax table (except maintenance orders, which have always been taxed at marginal rates).

- **Transfers**

During an inter-fund transfer such as a section 14 transfer, members will have to transfer all the pots to the receiving fund. The retirement pot in the transferring fund may only be transferred to the retirement pot in the receiving fund. The savings pot and vested pot may be transferred to either the corresponding pot, or to the retirement pot in the receiving fund.

Retirement pots and savings pots cannot be split between funds. In other words, a member cannot transfer their savings pot to another fund without also transferring their retirement pot to that same fund. All the pots must be transferred to the new fund.

Transfers can be made into the retirement pot at any time from the savings pot of the member in their own fund (intra-fund transfers). No intra-fund transfers can be made into the vested pot or savings pot.

These inter and intra fund transfers will be tax-free, but subject to the fund obtaining a tax directive.

Comment: *The RLAB suggests that a form of tax directive system will be applied to intra-fund transfers. This will require development by SARS, and at this point it is not clear what the process will entail.*

- **Approved risk benefits**

Amounts payable by insurers to funds in respect of insured death or disability benefits, will flow in the same proportions as contributions into the savings and retirement pot.

- **Proposed changes to section 37D of the Pension Funds Act (the Act):**

  A savings pot withdrawal may be refused, unless the fund is satisfied that the withdrawal will not compromise the fund's ability to make section 37D deductions.

- **Housing loans**

  In line with regulation 28 of the Act, it is proposed that the amount that is granted to a member as a housing loan or housing loan guarantee be capped at 65% of a member's benefit available in all pots.

  Further conditions for providing housing loans or guarantees may be prescribed by the FSCA.

Comment: *The wording in the draft RAPLAB seems to indicate that the fund will have to ascertain what the outstanding loan balance is, and if the outstanding balance is more than the vested pot and retirement pot, the member may be refused withdrawals from the savings. The Income Tax Act will have to be aligned if that is the intention.*

- **Employer damage claims**

  Changes are proposed to section 37D of the Act, including the provision that employer damage claims may be deducted when a member's employment with an employer terminates (currently when a member ceases to be a member of the fund).

  If a member has a housing loan granted by their employer or judgement for damages has been granted in favour of the employer, a fund will only be permitted to allow the member to withdraw from the savings pot if the employer consents thereto, unless the value in the other two pots is sufficient to cover the housing loan or judgement amount.

- **Maintenance orders**

  A fund may not allow a member to withdraw from the savings pot where there is a maintenance order in place, unless it is satisfied that the withdrawal will not cause the remaining amount to be insufficient to comply with the order.

Download:

- The two-pot system proposals in a nutshell
- Frequently Asked Questions