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THE PRESIDENCY

NO. 202 **29 FEBRUARY 2016**

INDEPENDENT COMMISSION FOR THE REMUNERATION OF PUBLIC OFFICE BEARERS

RECOMMENDATIONS TO THE PRESIDENT FOR THE AMENDMENT OF THE POLITICAL OFFICE-BEARERS PENSION FUND

BACKGROUND

1. The Taxation Laws Amendment Bill, 2015 ("TLAB 2015") was passed by the National Assembly on the 27 November 2015 and then later passed by the National Council of Provinces on 01 December 2015. The TLAB 2015 has been proclaimed in the Government Gazette on 08 January 2016 and is now the Taxation Laws Amendment Act of 2015 ("TLAA").

2. The TLAA brings major changes to the tax regime for retirement funds and associated insured benefits, with effect from 01 March 2016. These tax changes will have a significant impact on members of the Political Office Bearers Pension Fund (the "POBPF").

3. For members of the POBPF, the key change is to the tax treatment of the contributions to the pension fund (POBPF) itself. Currently, the member contributions of 7.5% of pensionable salaries are made on a pre-tax basis. The employer contributions – both those made by Parliament and the Provincial Legislatures and the contributions payable by National Treasury to fund the Additional Service Benefits and Equalisation Amounts – are not taxed in the hands of the members and are therefore also, in effect, made on a "pre-tax" basis.

4. As from 01 March 2016, the tax regime for both member and employer contributions will change completely. Specifically, the actuary to the Fund will have to calculate a "deemed" contribution rate (expressed as a percentage of members' pensionable salaries) which is meant to represent the "true" cost of the benefits provided by the Fund, on a calculation basis prescribed by the Minister of Finance in regulations to the Income Tax Act.

5. If the deemed contributions exceed the lower of (a) R 350 000 per year, or (b) 27.5% of the member's total annual taxable remuneration, the excess must be taxed through the PAYE system.

6. Regardless of the actual contributions being paid, the deemed contributions (i.e. the deemed contribution rate calculated by the actuary, multiplied by the pensionable salary) must be treated as fringe benefits in the hands of the POBPF members.

7. For members of the POBPF, this deemed contribution rate will be in excess of 60% of pensionable salaries, and consequently, members will attract an additional (and significant) fringe benefits tax from 01 March 2016.

8. A member's annual taxable remuneration will include the deemed contributions themselves, therefore it is likely to be significantly higher than the gazetted remuneration package (which excludes the cost of the Additional Service Benefit and Equalisation Amount).

9. The impact of this change is likely to be significant (estimated to be between R 1 200 and R 22 000 per month depending on the level of remuneration of the member) and the Commission consequently believes that it is appropriate that the benefit structure in place be reconsidered in order that members are not negatively affected by this change in legislation.

10. The Commission on 18 December 2013 published recommendations wherein we noted that the existing rules of the POBPF provide benefits which, in the opinion of the Commission, are unsustainable over the long term. The generosity is largely the consequence of the implementation of the Commission's recommendations set out in the Second Major Review, which sought to address the inadequacies of retirement funding benefits for members and stakeholders who were largely fighting the struggle during their earlier years.

11. The benefit arrangements are extremely generous and consequently expensive. They are inappropriate for newly appointed Public Office Bearers and very complex. The arrangements also lead to perverse incentives and decisions by the members which will not suit the State nor the people that have entrusted them with their vote of confidence. There are also problems in making these benefits accessible to Traditional Leaders. In a letter dated 05 June 2014, His Excellency requested the Commission to consider reviewing the terminal benefits of MPs and MPLs. The Commission acceded to the request on 30 July 2014.

12. In pursuing the review of pension benefit structure, the Commission engaged National Treasury, the Legislative Sector Forum and the POBPF Board of Trustees in order to formulate the terms of reference for the review. Furthermore, the Commission resolved to embark on a total overhaul of MPs and MPLs remuneration including pension.

13. On 18 September 2015 during the statutory consultation with National Treasury on the annual remuneration recommendation for 2015/2016, the National Treasury advised the Commission of the pending implementation of TLAA and its ramification on MPs and MPLs pension benefits.

14. The Commission received a submission from the Honorable Minister of Finance, dated 15 December 2015, outlining a proposal to amend the POBPF rules and termination gratuities. The submission was discussed by the Commission meeting dated 29 January 2016.

15. The Commissioners were deeply divided. There were some who held the view that it is unfair and immoral to enact a law and subsequently or simultaneously exempt the law makers from its negative effects. They felt that the Commission was, in effect, requested by the Honorable Minister of Finance to start the process of giving immunity to Political Office Bearers against the negative effects of the Amendment Act. The majority however resolved to make the following recommendation.

16. The changes brought about by the TLAA unfortunately require a further and more immediate review of the pension arrangements of POBs, in order that members are not severely prejudiced by these changes.

RECOMMENDATION

17. The Commission recommends that short term changes be effected to the POBPF, in order to place members in a "no worse off" position to what they would have been, had the TLAA not been implemented.

18. Specifically, the Commission recommends that the Rules of the POBPF be amended as follows:

18.1 Members' benefit entitlements in terms of the current Rules vest in full as at 01 March 2016 – this means that any entitlement that a member has, under the current Rules, to an Additional Service Benefit and an Equalisation Amount (or Terminal Gratuity) on 29 February 2016, will be added to the member's basic fund credit on 01 March.

18.2 For service from 01 March onwards, the only in-Fund benefit that will accrue will be the basic fund credit comprising members' 7.5% contributions plus the employer's 17% retirement-funding contributions.

18.3 There will be no further in-Fund accrual of the Additional Service Benefit and the Equalisation Amount (or Terminal Gratuity) for service after 01 March 2016.

18.4 If a member should leave after 29 February 2016 and up to and including the 2019 Election, a calculation will be done of what his/her benefits would have been under the "old Rules". If the amount is greater than the actual Fund benefit under the amended Rules, the difference will be paid to him or her outside the Fund as an employer-paid gratuity. This gives effect to a "no worse off" promise (before tax), for service up to and including the 2019 election date. This extends also to members joining the Fund after 29 Feb (up to the date of the 2019 Election).

18.5 For those members who return after the 2019 Election, a similar calculation will be done and a gratuity amount calculated for them. However, they will only receive this gratuity amount, which would be increased in line with inflation, when they eventually leave office, even if this is many years in the future.

18.6 Members who joined the Fund after the 2014 Election will not yet have completed 5 years in office by the time of the 2019 Election and therefore will not qualify for the Equalisation Amount at that date, or until they have served for more than 5 continuous years. So the gratuity calculation for them, if they return after the 2019 Election, will be split into a vested portion representing the Additional Service Benefit and a non-vested portion representing the Equalisation Amount, and they will only be entitled to the non-vested portion if they leave office with more than 5 continuous years of service.

19. The Commission recommends that careful consideration be given to all membership types and peculiarities, in an endeavour to ensure that all members are "no worse off" as a consequence of this change. (The changes needed should also address members, for example, who are "capped" as at 29 February 2016 or who might be "capped" by the 2019 Election.)

20. The Commission recommends that His Excellency, the President considers the significant administrative processes needed to put into effect these recommendations, which would include such things as amendments to Rules of the POBPF, communication to the various pay-points, and member related communications.

21. A further consideration that requires His Excellency's input will be the party responsible for paying the gratuity amounts (i.e. the "pay points" and not the Fund).

Judge CJ Musi
Chairman: Independent Commission for the Remuneration of Public Office Bearers

Date: