



Econ3x3

www.econ3x3.org

A web forum for accessible policy-relevant research and expert commentaries on unemployment and employment, income distribution and inclusive growth in South Africa

Downloads from this web forum are for private, non-commercial use only. Consult the *copyright and media usage guidelines* on www.econ3x3.org

September 2021

A redistributive approach to paying for a universal pension contribution subsidy

Andrew Donaldson, *University of Cape Town*

This is part 3 of a three-part series on pension fund coverage. The first article provides estimates of the size of the pension coverage gap, the second deals with the fiscal costs of co-funding universal coverage, and this article suggests how this might be paid for.

How could a universal pension scheme be funded?

A retirement funding tax reform could contribute to offsetting the costs associated with subsidising pension fund participation by low-income contributors. It would do so by reducing the tax benefit associated with retirement fund contributions by high-income contributors, which rises disproportionately as an indirect effect of the progressivity of the personal income tax structure. We summarize this below.

This reform would improve the progressivity of the personal income structure, and would contribute, over time, to reducing inequality. To avoid disruptive effects on disposable income, its implementation could be phased in over a few years, as part of the annual adjustments to PIT rates and schedules.

This proposal takes as point of departure that an effective fiscal incentive should be maintained for contractual savings. Currently, contributions, within limits, are exempt from tax, in-fund accumulation is largely tax-free, and drawdowns after retirement are taxed. From a welfare and incomes policy perspective, it seems clear that the social benefit of fiscal support for saving and lifetime income-smoothing declines as income and wealth rise. But it is nonetheless important to recognise that the current arrangements have the effect of deferring tax: tax relief in the contribution phase is accompanied by tax in later years on drawdowns.

A significant impact of this reform will be a narrowing of the tax-induced distortion between contractual and discretionary saving by higher income taxpayers. Although care should be taken not to discourage regulated contractual saving, a narrowing of the tax wedge between different savings forms is likely to be welfare-enhancing and to contribute to financial market efficiency.

Estimates are set out in **Table 1** of the 2021/22 tax benefit to retirement fund contributors, based on SARS and Treasury tax statistics for the 2017 tax year, raised to 2021 prices. The

available data covers assessment of approximately 85% of revenue collected – the estimates below adjust taxpayer numbers up to align with the Treasury’s estimated total tax base and the personal income tax revenue outcome for 2016/17. These estimates include retirement fund contributors whose taxable income falls below the tax threshold.

The numbers include taxpayers employed for less than a full year. This results in somewhat higher numbers of contributors, particularly in lower contribution bands, than would be found in a survey taken at a point in time.

Retirement fund contributions are deductible up to a maximum of the lesser of R350 000 or 27.5% of remuneration or taxable income. The implied fiscal cost therefore depends on the marginal tax rate – for taxable incomes below R216 200 (or gross income including retirement funding contributions of R247 000 on average) it is 18% of the contribution; for taxable incomes above R1 656 600 (gross income of R1 975 000) it is 45%.

Table 1: Gross income, retirement fund contributions and tax benefit estimates, 2021/22

Gross income (R)	Marginal tax rate	Number of contributors	Average gross income (R)	Average RF contribution (R)	Average tax benefit (R)	Total tax benefit cost (R m)
1 – 98 500	0%	1 418 878	52 173	6 141		
98 500 – 247 000	18%	2 061 020	161 892	19 521	3 514	7 242
247 000 – 353 000	26%	981 427	299 301	40 643	10 567	10 371
353 000 – 494 000	31%	932 856	424 233	61 108	18 943	17 671
494 000 – 706 000	36%	688 009	587 446	80 686	29 047	19 985
706 000 – 917 000	39%	277 039	760 255	94 607	36 897	10 222
917 000 – 1 975 000	41%	399 884	1 206 380	138 431	56 757	22 696
>1 975 000	45%	87 896	3 743 031	255 230	114 854	10 095
All contributors		6 847 010	368 537	44 596	14 354	98 282
Contributors > tax threshold		5 428 131	451 233	54 648	18 106	98 282

Estimates are set out in tables 2 and 3 of the implied revenue impact of two alternative tax structures.

In the first, the tax benefit is set at 26%, equal to the second marginal rate. This has the effect of raising the benefit at incomes below approximately R250 000, while reducing the tax benefit at incomes above R350 000.

This could be implemented either as a formula-based deduction or a rebate. Arithmetically, the simplest form is a rebate equal to 26% of contributions to approved funds, up to a maximum of R91 000 (equal to 26% of R350 000).

If the rebate is reimbursable, then it is in effect a subsidy to contributors below the tax threshold. In **Table 2**, the 26% tax benefit is shown for contributors below the tax threshold, and the total revenue gain is calculated both for a reimbursable (all contributors) and a non-reimbursable (contributors above the tax threshold only) option. In both options, there is a net gain to contributors (and loss to revenue) in the 18% tax bracket.

The second tax alternative, calibrated to generate about the same net revenue gain as the above, is a deduction calculated at stepped inclusion rates. The example in **Table 3** has the following form:

RF contribution pa	Inclusion rate	Allowed deduction
< R50 000	100%	Full contribution
R50 000 – R100 000	50%	R50 000 + 50% of amount exceeding R50 000
> R100 000	25%	R75 000 + 25% of amount exceeding R100 000

Table 2: Retirement fund contribution tax benefit set at 26 percent, 2021/22

Gross income (R)	Marginal tax rate	Number of contributors	Average RF contribution (R)	26% tax benefit (R)	Difference (R)	Total revenue gain (R m)
1 – 98 500	0%	1 418 878	6 141	1 597	-1 597	-2 265
98 500 – 247 000	18%	2 061 020	19 521	5 076	-1 562	-3 219
247 000 – 353 000	26%	981 427	40 643	10 567		
353 000 – 494 000	31%	932 856	61 108	15 888	3 055	2 850
494 000 – 706 000	36%	688 009	80 686	20 978	8 069	5 551
706 000 – 917 000	39%	277 039	94 607	24 598	12 299	3 407
917 000 – 1 975 000	41%	399 884	138 431	35 992	20 765	8 303
>1 975 000	45%	87 896	255 230	66 360	48 494	4 262
All contributors		6 847 010	44 596			18 891
Contributors > tax threshold		5 428 131	54 648			21 156

Table 3: Stepped inclusion rate of deduction of retirement fund contributions, 2021/22

Gross income (R)	Marginal tax rate	Number of contributors	Average RF contribution (R)	Tax benefit (R)	Difference (R)	Total revenue gain (R m)
1 – 98 500	0%	1 418 878	6 141			
98 500 – 247 000	18%	2 061 020	19 521	3 514		
247 000 – 353 000	26%	981 427	40 643	10 567		
353 000 – 494 000	31%	932 856	61 108	17 222	1 722	1 606
494 000 – 706 000	36%	688 009	80 686	23 523	5 523	3 800
706 000 – 917 000	39%	277 039	94 607	28 198	8 698	2 410
917 000 – 1 975 000	41%	399 884	138 431	34 689	22 067	8 824
>1 975 000	45%	87 896	255 230	51 213	63 640	5 594
All contributors		6 847 010	44 596			22 234
Contributors > tax threshold		5 428 131	54 648			22 234

A simple comparison of the present contribution deductibility with these alternatives is set out in **Table 4**. Currently, the tax benefit as a percentage of gross income is highest for the R494 000 – R917 000 income groups. In the alternative tax structures, it is highest for the R353 000 – R494 000 bracket.

Table 4: Comparison of RF contribution tax alternatives, 2021/22 estimates

Gross income (R)	Average RF contribution (R)	Tax benefit (R)			Tax benefit as % of gross income		
		Present deduction	26 % benefit	Stepped inclusion	Present deduction	26 % benefit	Stepped inclusion
1 – 98 500	6 141		1 597		0.0%	3.1%	0.0%
98 500 – 247 000	19 521	3 514	5 076	3 514	2.2%	3.1%	2.2%
247 000 – 353 000	40 643	10 567	10 567	10 567	3.5%	3.5%	3.5%
353 000 – 494 000	61 108	18 943	15 888	17 222	4.5%	3.7%	4.1%
494 000 – 706 000	80 686	29 047	20 978	23 523	4.9%	3.6%	4.0%
706 000 – 917 000	94 607	36 897	24 598	28 198	4.9%	3.2%	3.7%
917 000 – 1 975 000	138 431	56 757	35 992	34 689	4.7%	3.0%	2.9%
>1 975 000	255 230	114 854	66 360	51 213	3.1%	1.8%	1.4%

In both these tax reform options, there is, by design, no net impact on taxpayers in the 26% bracket (gross income of around R247 000 – R353 000). In higher tax brackets, the reduced deductibility raises the tax burden progressively. At income levels above R1 million, in the absence of offsetting bracket or rate changes, tax payable increases by about 1.7% of gross income.

This analysis illustrates a possible reform of the tax treatment of retirement fund contributions that could offset the costs of subsidising universal pension coverage, while making the personal income tax somewhat more progressive.

A spreadsheet model that shows the revenue impact of alternative parameters for the retirement contribution tax reforms is appended below.

Pension Tax Model

Tax benefit of retirement fund contributions - 2016/17 taxpayer and contributor numbers in 2021/22 prices and tax brackets

Gross income calculated as taxable income plus RF contribution

Source: Adapted from Personal Income Tax Statistics for 2017 in SA Tax Statistics 2019 and 2020

Taxable Income Threshold (lower threshold)		Gross income threshold		RF	Contributors as % of taxpayers	Average Contribution	Average Taxable Income	Gross Income	Average Contribution Rate		
2016/17	2021 prices	R	R			R	R	R			
> 0	> 0			0	3 729 242	1 418 878	38,0%	6 141	46 032	52 173	11,8%
70000	85890	88 500	98 500	3 017 854	2 061 020	68,3%	19 521	142 371	161 892	12,1%	
175000	214724	221 000	247 000	1 185 133	981 427	82,8%	40 643	258 658	299 301	13,6%	
250000	306748	316 000	353 000	1 050 608	932 856	88,8%	61 108	363 125	424 233	14,4%	
350000	429448	442 000	494 000	761 683	688 009	90,3%	80 686	506 760	587 446	13,7%	
500000	613497	632 000	706 000	307 659	277 039	90,0%	94 607	665 648	760 255	12,4%	
650000	797546	822 000	917 000	448 514	399 884	89,2%	138 431	1 067 949	1 206 380	11,5%	
1400000	1717791	1 769 000	1 975 000	103 880	87 896	84,6%	255 230	3 487 801	3 743 031	6,8%	
Total number income >0				10 604 573	6 847 010	64,6%	44 596	323 941	368 537	12,1%	
Total above tax threshold				6 875 331	5 428 131	79,0%	54 648		451 233	12,1%	

Tax benefit: current tax deduction

Gross income threshold Contributor:	Marginal tax rate	Average Tax benefit per contributor	Tax benefit R m	Total Gross Income R m	Contributors Gross Income R m	Contributions R m
0	0			180 377	74 027	8 713
98 500	0,18	3 514	7 242	469 887	333 662	40 234
247 000	0,26	10 567	10 371	346 432	293 742	39 888
353 000	0,31	18 943	17 671	438 507	395 748	57 005
494 000	0,36	29 047	19 985	441 503	404 168	55 513
706 000	0,39	36 897	10 222	231 003	210 620	26 210
917 000	0,41	56 757	22 696	534 346	482 412	55 356
1 975 000	0,45	114 854	10 095	384 747	328 997	22 434
			14 354	98 282	3 026 801	2 523 376
			18 106			305 352

Tax benefit: standard rate tax deduction

Gross income threshold Contributor:	Marginal tax rate	Average tax benefit R	Tax deduction at standard rate Difference R	Revenue gain R m
0	0	1 597	(1 597)	(2 265)
98 500	0,18	5 076	(1 562)	(3 219)
247 000	0,26	10 567	-	-
353 000	0,31	15 888	3 055	2 850
494 000	0,36	20 978	8 069	5 551
706 000	0,39	24 598	12 299	3 407
917 000	0,41	35 992	20 765	8 303
1 975 000	0,45	66 360	48 494	4 262
Total above income >0				18 891
Total above tax threshold				21 156

Tax benefit: Stepped tax deduction

Gross income threshold		Stepped tax deduction			Stepped tax deduction parameters		
Contributor:	Marginal tax rate	Average tax benefit	Difference	Revenue gain	Threshold (R)		Inclusion rate
R		R	R	R m			
0	0				50000	Below: 50000	100%
98 500	0,18	3 514	-	-		to 100000	50%
247 000	0,26	10 567	-	-		Above: 100000	25%
353 000	0,31	17 222	1 722	1 606			
494 000	0,36	23 523	5 523	3 800			
706 000	0,39	28 198	8 698	2 410			
917 000	0,41	34 689	22 067	8 824			
1 975 000	0,45	51 213	63 640	5 594			
Total				22 234			