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DIGEST TO THE NATIONAL SOCIAL SECURITY FUND AMENDMENT BILL, 2019

August 2019

Background

The Ministry of Gender, Labor and Social Development recently tabled the NSSF Amendment Bill, 2019 for its first reading in Parliament. This Bill has since caused lots of mixed reactions amongst the public and it seeks to amend the provisions of the NSSF Act, Cap 222 of 1985, laws of Uganda (hereinafter referred to as Principal Act). The purpose of this publication is to give our perspective on the Bill and its the implications to employers and employees.

The general policy, principle and gist behind the Bill is to expand social security coverage by making contributions to the National Social Security Fund mandatory for all workers in the formal and informal sectors, to enhance the spectrum of benefits available to workers and to improve the management of the Fund and above all cause a betterment of the economy.

The proposed amendments enlisted thereunder once passed by the Parliament of the Republic of Uganda and assented to by His Excellency the President of the Republic of Uganda will become law. The said law will thereafter be published in the Uganda gazette and will commence effectively on a date specified therein.

In our view, the objectives and principles informing the proposed amendments are good for the members of the NSSF and the economy as a whole. However, some elements of the Bill need to be improved in order to realize the intended objectives. For example, the taxation regime proposed requires improvement and lending to government needs to be removed or restricted to shield the Fund from the risk of government interference in the investment decisions of the Fund. Details of our observations are highlighted in the proceeding pages.

Summary of Proposed Key Amendments

- Change of the taxation regime for social security contributions, investment returns and benefits.
- Compulsory registration and membership to the Fund. Introduction of voluntary contributions over and above the standard contributions of 5%.
- Recoveries from third parties owing money to a defaulting contributing employer.
- Midterm access to voluntary contributions to be allowed in a prescribed manner.
- Capping the payment of an annual levy to the Uganda Retirements Benefits Regulatory Authority.
- Increase of penalties for failure to comply with the provisions of the Act.
- Contributing employer to include all employers regardless of the number of employees.

Details of the proposed Amendments

Exemption of employee contribution from tax

- Currently, 5% employee contribution is included in the amount subject to income tax.
- Section 38(1) of the Bill proposes that all member contributions not exceeding 30% of income of the member shall be exempt from tax. This means that a member's NSSF contribution of up to 30% (5% standard contribution and 25% voluntary contributions over and above the 5%) shall not be subjected to Pay As You Earn (PAYE). This will reduce the chargeable income of the employee thereby reducing the tax element and increasing the net pay.

The extent of income is however not defined by the Bill and neither is it defined in the current NSSF law. Under the Income Tax Act, income of an employee includes both cash and non-cash benefits. However, social security contribution is only applied on the gross cash wages as per the current NSSF Act. To avoid this confusion, the 30% limit should be in reference to "gross cash wages" instead of "income".

Exemption of employer's contribution from tax

- Currently, the 10% employer's contribution is exempt from tax at the point of contribution and at the point of a member claiming benefits from NSSF.

The Bill proposes to maintain the exemption of the employer's contribution from tax at the point of remitting the contribution to NSSF. However, the Bill does not specifically provide that this contribution will also be exempt from tax at the point of a member claiming the benefits from NSSF. This should be clarified in the proposed law to avoid the employer's contribution being subjected to tax at the point a member receives benefits from NSSF.

Exemption of investment income from tax

- Currently, the income NSSF derives from investment of contributions received from members and employers is subject to income tax.
- The Bill proposes that the investment income of the Fund shall be exempt from income tax.

This implies that NSSF will have more funds for reinvestment and generate more returns to grow the fund and the benefits available to members at retirement.

Additionally, as part of its investment portfolio, NSSF currently invests in other countries such as Kenya and Tanzania. The exemption of the Fund's investment income from tax has the effect of making investments in Uganda more attractive and increasing the multiplier effect of money in the economy.

Taxation of benefits at the point of payment to a member

- Currently, benefits to members are not taxed because they were taxed at the point of contribution or earning the investment income as noted above. Given that the Bill proposes to exempt the contributions and investment income from tax, it is proposed that taxation should only arise at the point a member accesses the benefits from NSSF.

However, taxation shall not apply under the following circumstances;

i. Benefits accessed when the member is 60 years or more,

ii. Benefits to a member in case of invalidity (physically or mentally incapacitated),

iii. Benefits payment to a member's beneficiaries in case of death of a member.

Given the low life expectancy in Uganda and the underlying purpose of the benefits being social protection at old age, there is need to improve the taxation structure of benefits for members who are between 50 and 59 years as follows:

i. Set a tax free threshold say 80 million given that majority of members earn very low wages and need a livelihood at old age.

ii. To be fair to members who may not be able to wait till 60 years for various reasons, exempt a proportion of the benefits for each year up to 59 years, for example, exempt 15% at 50 years, 50% at 59 years.

Furthermore, in case a member contributed above the exemption threshold of 30%, the excess is subject to PAYE at the point of payroll processing as per the Bill. However, the Bill does not specifically exempt this excess from taxation at the point the member accesses the benefits. The Bill needs to be adjusted to avoid double taxation of this amount at the benefits payment time.

❑ Member's balance prior to the coming into force of the new law

❖ As a transition measure, the Bill provides that benefits that accrue to a member before coming into force of the Bill will not be taxable. This is because these benefits have already suffered tax. However, the Bill does not specify that the corresponding interest earned on this opening balance going forward is also exempt from tax. There is need to provide this clarity in the Bill to ensure that the member's opening balance is sheltered from the effect of inflation at the time of accessing the benefits.

❖ The NSSF will be expected to ring fence each member's opening balance to ensure that it does not suffer tax again at the point of payment of benefits to the member.

❑ Obligation to withhold tax from a member's benefits

❖ The Bill, if passed into law, would effectively amend the Income Tax Act. Currently, the NSSF does not have the mandate to withhold tax on a member's benefits. The Bill should be adjusted to mandate NSSF to withhold the tax and remit it to URA by the 15th of the following month.

❑ Voluntary Contributions

❖ To encourage savings, an employee is permitted to increase their contribution over and above the standard rate of 5%. This also has a tax exemption incentive for the employee up to 30% of the employee's income.

❖ Self-employed persons and any other persons are also permitted to save with the NSSF and contribute over and above 5%.

❖ It will be an offence for an employer who deducts voluntary contributions of the employee and the same is not remitted to the Fund. The Employer upon conviction will be liable to a fine not exceeding Uganda Shillings Ten Million or imprisonment not exceeding one year or both.

❖ Regulations will be prescribed by the Minister on the procedure for making voluntary contributions and benefits.

❖ Whereas the Bill permits an employee to increase their savings above 5%, it does not prescribe the frequency within which the saving rate can be varied by the employee. This implies that an employee can vary the rate to 7% in month one, 8% in month two, 10% in month three, and so on and then back to 5%. For an employer with many employees making variations to their standard contributions on a monthly basis, this is likely to create additional

administrative burden. To minimize this problem, there should be a cap on the number of times an employee can vary their contributions in a quarter, half year or year. For example, where an employee chooses to contribute above 5%, the varied rate should not be changed within a three month period.

Compulsory registration and membership to the Fund

- Currently, only employers with five or more employees are required to make a contribution to the Fund.
- In spirit of compliance with Paragraph VII of the National Objectives of Directive Principles of State Policy under the Constitution, the International Labor Organization Convention 102 on social security and the State Protection Policy of 2015, calling for social security coverage of all persons regardless of the number of their employees, the Bill makes it mandatory for all employers and employees to make a contribution to the Fund regardless of the size of the enterprise or number of employees.
- Whereas expansion of coverage is a welcome move, there is need to consider the impact it may have on small businesses/start ups and their ability to create jobs. Uganda is known to have many business start ups but they don't survive for long; they struggle to meet their payroll costs among other things. The question is whether the additional cost of 10% NSSF contribution will not accelerate their demise. Small businesses or startups within a certain income/capital category employing less than 5 people may have to be excused from the mandatory contributions until a study is done to assess the most effective way of bringing them into the mandatory bracket.

Lending to Government

- Currently the law provides that monies in the Fund shall be invested in such investments as may be determined by the board in consultation with the Minister of Finance. The Fund's asset classes invested in currently includes government securities (treasury bills and bonds).
- The Bill proposes that the Board may use in-house expertise or fund managers in carrying out investments including **lending to government.** It is not clear why the Bill has to specifically make reference to "lending to government" when the current law permits the Fund to invest in government securities (a form of lending to government) through the open market.

It may be interpreted that this proposal is intended to expand the scope of lending to government. However, the Bill does not prescribe any terms and conditions for lending to government. Given that the Fund is supervised by Government, the proposed expansion of lending to government may impair the independence of the board when making investment policy and decisions. This may affect the Fund's ability to judiciously invest contributions in a manner that ensures protection of members' funds, provision of real returns to members and payment of benefits to members when they fall due.

The proposal to expand lending to government should not be without conditions to shield the Fund from the risk of government interference in the investment decisions of the Fund.

Use of in-house expertise to assess investment choices

- Currently, Section 33 of the Uganda Retirement Benefits Regulatory Authority Act 2011 requires that all funds of a retirement benefits scheme should be invested through a private fee charging fund manager. This has overtime proved to be costly for NSSF yet the Fund has invested in in-

house capacity. To reduce expenditure of the Fund, the Bill gives the board discretion regarding use of in-house expertise or external fund managers with respect to investments. This implies that the board will have to assess and determine which investments can be undertaken without involvement of external fund managers.

Recoveries from third parties owing money to a defaulting employer

- The Bill seeks to empower the NSSF to recover from a third party any sum owed to a defaulting contributing employer to cover any contribution, penalty or interest.
- However, the Bill only creates an obligation for the third party but no consequences in case the third party does not comply with NSSF's requirement to remit funds owed to the third party. To close this loophole, as is the case with tax laws, the Bill should be enhanced to provide that the third party becomes liable in case they fail to remit funds they are holding on behalf of the defaulting employer.

Midterm access to benefits

- The Bill proposes that a member who has made voluntary contributions to the fund shall be allowed midterm access to his or her benefits on such terms and conditions and in a manner prescribed by Regulations. For clarity and certainty, there's need to spell out the meaning of "midterm access".

Additional benefits to members

- The Bill also introduces subsection 1(a) under Section 19 of the NSSF Act to provide that the Board may, in consultation with the Minister of Finance prescribe additional benefits for members in a statutory instrument. What constitutes "additional benefits" is not defined in the Bill.

Annual payment to Uganda Retirement Benefits Regulatory Authority

- The Bill proposes that an annual levy not exceeding 0.05% of the total assets of the Fund or Ushs 4 billion, whichever is less, shall be paid to the Uganda Retirement Benefits Regulatory Authority.

This essentially seeks to put a ceiling to the regulatory levy.

Offences and Penalties

- The Bill proposes to increase the penalty for non-compliance with any of the provisions of the Act whose offence and/or penalty is not specifically provided from Uganda Shillings Ten Thousand (Ushs 10,000) to Ushs 10,000,000 or to one-year imprisonment from six months.

This proposal is meant to encourage voluntary compliance as the cost of noncompliance will be high.

Definition of Employer

- Employer proposed to include company incorporated under the Companies Act, Partnership registered under the Partnership Act, Trustee incorporated under Trustees Incorporation Act, Business registered under any other law and any other governing body of an unincorporated association.

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In case you require advice on any matter, please contact a professional, our team of experts is available to help.

OUR KEY CONTACTS

KENNETH MAKANGA
Partner
Tel: +256 414 220 371/ 3
Email: kenneth.makanga@bdo-ea.com

JOHN JET TUSABE
Director, Tax
Tel : +256 414 220 371/3
Email : john.tusabe@bdo-ea.com

JUMA BULI
Senior Manager
Tel: +256 414 220 371/ 3
Email: juma.buli@bdo-ea.com