Steering work and retirement

Budget 2012 Proposals – November 2011

Always plan ahead: It wasn't raining when Noah built the Ark

˜ Richard C. Cushing

Four objectives have been identified as the main drivers in the budget 2012 speech "Growth for greater good." These objectives span from setting the basis for strong growth, riding out the crises, improving social protection to bringing fiscal reform. In the face of dire international economic conditions, growth would not be possible unless the country is protected from the ruthless conditions prevailing in the international market. Fiscal reform has been a major element in trying to promote investment and growth. Social protection is crucial for Mauritius as the main factor of production in the development of Mauritius has been its labour force. We at Aon Hewitt, one of the world's leading human capital and employee benefits consulting firms, have been particularly interested in the budget proposals in these areas and offer our analysis and comments on them in this News Alert.

Retirement

Focusing further on the issue of social protection and labour market, the budget speech has announced customary increases to the Basic Retirement Pension (BRP) to compensate for the loss in purchasing power of the retirees.

Another major announcement is the incentive to encourage people working in the informal sector to join the National Pension Fund (NPF). The government would be contributing to the NPF on behalf of employees earning up to Rs3,000 who are currently in the informal sector. These workers are usually deprived of the benefits accruing to employees under prevailing labour legislations, namely participation in the NPF and provision for recycling in case of redundancy or loss of job. This measure will ensure that people employed by the informal sector are not left as solely dependent on the BRP after retirement while at the same time ensuring a support mechanism in case of loss of employment. However, as the informal sector may not be operating with required permits and may not be complying with the legislation, it may still be difficult to obtain the cooperation of their employers as we presume they would also have to pay their required share of contributions.

Nonetheless, these measures may eventually force firms operating in the informal sector to legalise their status. To encourage this process, the government has maintained its effort into making the environment more business friendly by further streamlining permits and providing softer treatment to tax evaders who wish to declare their income.

On the economic side, when the informal sector would join the formal sector, their output will start to show up in the national income figures. In terms of compliance, since MRA will be issuing the statement of emoluments, the MRA will be able to identify enterprises operating in the informal sector more easily. Better monitoring will ensure better compliance to legislation and tax payments.

In the same vein, the government has further announced that employees willing to participate in a medical scheme may divert the contributions currently made for them to the National Savings Fund (NSF) for this purpose as from January 2012. This measure effectively provides employees with the option to opt out of the NSF in favour of a medical scheme. Although this measure would encourage employees to invest in a medical scheme, hereby reducing the burden on health services provided by the government, it will at the same time deprive the employee of a potentially valuable lump sum at retirement.

The objectives of a retirement savings fund such as the NSF and a medical scheme are very different. The NSF provides for a lump sum on retirement which can be useful to pay off any outstanding loans or provide a cushion against unforeseeable expenses in retirement, including medical treatment. On the other hand, a medical scheme is like an ongoing insurance expense which would provide a benefit only for the period the contribution has been made for and not beyond. Moreover, there are already many employers who contribute to a medical scheme for their employees in addition to existing contributions to the NSF and the NPF.

While the NPF and NSF go some way in ensuring that employees do not become completely dependent on others after retirement, it is also clear that they, together with the BRP, are not sufficient to maintain a reasonable standard of living for most Mauritians in old age. In fact many persons/families are thrown into poverty after retirement.

Private occupational pensions have become almost a normal industry practice in Mauritius for certain categories of workers and in some sectors in particular. Unfortunately, owing to lack of legal and disclosure requirements, many members of such occupational pension schemes remain unaware of their rights and expectations under them. The adequacy of the assets of pension schemes to cover the benefits already promised can be revealed at regular actuarial valuations and legislation in this area could help improve the monitoring of their financial health and the security of members' benefits.

It has been years since such legislation has been announced and partly consulted upon with some stakeholders. Finally this budget puts a deadline, June 2012, to revive these discussions and come to a consensus. Compliance is a cost and over-regulation which can kill the well functioning industry should be avoided at all costs. Hopefully, this much awaited and debated legislation would add impetus to this industry with the right degree of requirements in terms of compliance.

The occupational pension scheme can also be a very efficient route to mobilize retirement savings, without loss of tax revenue for the government. Additional voluntary contributions (AVCs) linked to such a scheme are beneficial for the individuals as it gives them some flexibility in choosing the form of their retirement benefits as well as some control and choice over the investment of their funds. It also enables them to make up for absence of such savings in earlier periods of employment when they did not have access to such schemes. At the moment occupational pension schemes are not currently required to provide an internal AVC facility and such AVCs do not attract any tax relief. When reviewing the legislation on private occupational pensions, the government could already consider these points as well as making provision to give them appropriate incentives like tax exemption.

Knowledge based economy

Mauritius is not endowed with any natural resources. The main factor of production is labour which was responsible in making Mauritius move from an agriculture based economy on the verge of population explosion and failure, to a success story known as the Mauritian miracle. Labour was the catalyst in the first phase of transformation and is expected to play a major role in the move towards a service based economy.

While a cheap semi-skilled labour force was all that was required in the first phase of transformation, in order to move to a service economy, labour will have to be highly educated and skilled. The budget proposals on education set a new milestone in the attempt to making Mauritius a knowledge based economy.

One of the main visions in Mauritius has been to make Mauritius a regional hub for education. Many attempts have previously been made to attract foreign students to the universities in Mauritius. Attempts have also been made to welcome foreign universities to be based in Mauritius. In order to concretize this vision, beside allowing foreign students to take up part-time jobs of up to 20 hours a week in Mauritius, the minister has also announced speeding up granting of student visas as well as providing for the development of more capacity in Reduit.

Many students find it difficult to secure a job after they finish their studies: as pointed out in the budget speech, no job without experience and no experience without a job. The pre-training programme has been thought to break this vicious circle.

In order to promote more mobility in the labour market, the minimum qualifying or vesting period for pension portability which was revised from five years to two years in 2008 could again be reviewed downwards to perhaps full portability after the first quarter of 2012. This new measure would increase the cost of recruitment but could at the same time force employers to be more competitive in terms of recruitment as well as retention of employees.

We would have liked to see other proposals we have made in this area being acted upon. For example, the Income Tax Regulations currently prohibit employees from becoming members of an MRA approved occupational pension scheme unless they would be able to complete more than 10 years of service by the normal retirement age of 60/65 (depending on the scheme). This is not compatible with the vesting period of 2 years or potentially less and the removal of this restriction would go a long way in promoting mobility of skilled, experienced older employees.

In addition, deferred pensions should ideally be protected against the eroding effects of inflation or, at the very least, members of occupational schemes should be made aware of potential pension losses on leaving their employment through better disclosure and employee communications.

Remuneration

In terms of remuneration, the annual income exemption threshold (IET) has been increased by Rs15,000 for all categories of tax payers. Thus the IET increases by 3% to 6% depending on the number of dependents. This measure will make tax savings of up to Rs2,250 a year (Rs 173 a month) across the board. Households with larger numbers of dependents will be less better off than, say, individuals with no dependents. Households with larger number of dependents usually have only one person working and with children at school. The same percentage increase across the board (in line with inflation at 6.6%) instead of a fixed monetary amount would have been a fairer measure to us.

Furthermore, taxable car benefit has been increased by 50% and housing benefit by 100%. In general, we prefer small annual increases in line with inflation rather than major but less frequent increases which are always more difficult to adjust to.

The way forward

Certain pertinent issues still remain to be addressed. The government affirms that savings should not be penalized by being taxed twice in the context of the abolition of solidarity income tax on interest and dividends. Retirement schemes are also savings for retirement and the same treatment should be applied. Nevertheless, while contributions to approved pension schemes from employers are tax deductible, similar contributions from individuals are fully taxable since 2006. Such a system makes savings towards retirement taxed twice for individuals, initially when contributing and again when receiving the benefits at retirement in the form of taxable pensions. Individuals are therefore discouraged from saving towards their retirement.

Also, while the decision of how much to save for the future should be on each individual, the Income Tax Regulations limit savings for member pensions to 2/3 of final salary, spouse pensions to 1/3 of the member's pension and lump sums on death or disability to 2 years' salary. Such restrictions limit the benefits and scope of pension schemes.

Besides, efforts should also be made to educate the population about their responsibility to save and invest for their future through awareness programmes. NPF and NSF could play a vital role in the preparation of awareness programmes and in providing more regular information to their members on how their retirement benefits are building up.

A system of savings credit and/or tax credits, like the Saver's Credit in USA, could be put in place whereby anyone who makes an effort to set aside funds for retirement is rewarded through an additional State contribution. This can be limited up to a ceiling to prevent abuse and to target only those in need of such additional income.

There are numerous examples across the world which can be easily adapted to the Mauritian context. It should however be done with a lot of care and caution. The new private occupational pension legislation can be worked out with the mindset of promoting a savings culture in Mauritius, allowing "freedom with disclosure" rather than imposing costly requirements which could discourage employers from sponsoring such voluntary plans.

Contact Information

Bernard Yen, FIA
Managing Director
Aon Hewitt Ltd (Mauritius)
+230.210.3831
bernard.yen@aonhewitt.mu

Brinda Harjan
Financial Analyst
Aon Hewitt Ltd (Mauritius)
+230.210.3831
brinda.harjan@aonhewitt.mu

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Registered office: 5th Floor Barkly Wharf Le Caudan Waterfront Port Louis, Mauritius