Budget 2018

THE YEAR OF VAT AND WEALTH

The year of VAT and wealth #Budget2018
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South Africans are today counting the cost of Jacob Zuma’s disastrous leadership. But while they curse a 1% higher VAT rate; no inflation-rated adjustments for “bracket creep”; a 52c/litre fuel price rise; a jump from 7% to 9% in luxury import duties; and higher sin taxes, they might also allow themselves a sigh of relief.

It is obvious from today’s Budget allocations and tax adjustments that, although it’s barely two months since he won a razor thin majority in the vote for the ANC’s presidency, business-savvy Cyril Ramaphosa is already having an impact where it matters.

It is hard to believe his predecessor would have directed the implementation of a non-populist VAT increase rather than the populist alternative of jacking up the top marginal income rate. As it happens, after last year’s three percentage point hike in the top marginal income tax rate (to 45%) and higher dividend tax, both were left untouched this time.

Top income earners are still carrying a disproportionate burden, however, with the 270,000 (3.7% of the total) who report taxable income of over R1m a year now paying 38.5% of total personal income tax while earning 22% of the declared taxable income.

Economically illiterate Jacob Zuma handed his successor a political poison chalice by promising fee-free tertiary education to the children of all but around a million households. With the sweep of his populist hand, Zuma landed National Treasury with a headache now quantified as R57bn over three years.

At the traditional “lock-up” press conference, Zuma’s finmin Malusi Gigaba and his emotional deputy Sifiso Buthelezi offered a spirited defence of the decision to make university education free. Gigaba also argued that VAT doesn’t hurt the poor.

Sensible educationalists have long told us the real blockages in a broken education system lie a lot further down the chain. And Gigaba’s VAT argument is very definitely a minority among economic theorists who explain that broader collection vehicles are the antithesis of progressive tax systems.

But all of that is now water under the Zuma bridge.

There was zero room or time for creativity on stimulating economic growth this time. Ramaphosa didn’t have much time to get his hands around the national bookkeeping exercise. But he was helped by the excellent team at National Treasury whose leader, new DG Dondo Mogajane, said that he and his 1,200 colleagues have learnt that finance ministers have tended to come and go – so they focus on just getting on with the job.
They kept it simple: Treasury needed to fill a R36bn hole and find tens of billions to meet Zuma’s free university pledge. They did so by raising VAT and using the automatic revenue boost that inflation provides to tax scales (aka fiscal drag).

There were a few bits and bobs at the extremities. In essence, however, that’s the story of this Budget.

But in truth, these are little better than stop gaps. Ramaphosa’s Administration has been dealt a weak hand. And its priority is to get the economy growing again. Without a significant improvement in economic growth – and the projected rise from 1% to 1.5% won’t cut it – Treasury will be facing an even greater challenge next year.

This year there was a R48.2bn revenue hole that pushed the 2017/18 Budget deficit from the modest, healthy 3.1% projected by Pravin Gordhan a year ago, to a distressing 4.3%. That dropped SA from a place among respectable global company next to the likes of Malaysia and France, into the league of recovering basket cases like Argentina and Pakistan.

Ramaphosa needs to get that corrected – and fast – or risk further downgrades by ratings agencies. His renowned negotiating skills and trade union background must have been put to good effect in convincing organised labour to bend a cornerstone “no-VAT-increase-ever” position.

Gigaba ducked a question about whether there had been any negotiating on VAT with trade unions, claiming that it is senseless to engage ahead of any tax increases. But given their vociferous opposition in the past and their obvious potential to do damage, it is naive to believe this particular balloon wasn’t floated ahead of time.
The year of VAT and wealth #Budget2018

2018 BUDGET HIGHLIGHTS

BUDGET FRAMEWORK

- The budget deficit is projected to narrow from 4.3 per cent of GDP in 2017/18 to 3.5 per cent in 2020/21.
- Main budget non-interest expenditure is projected to remain stable at 26.6 per cent of GDP between 2017/18 and 2020/21.
- Net debt is expected to stabilise at 53.2 per cent of GDP in 2023/24.
- Proposed tax measures will raise an additional R36 billion in 2018/19.
- The fiscal framework reflects two major changes that followed the 2017 MTBPS: medium-term expenditure cuts identified by a cabinet subcommittee amounting to R85 billion, and an additional allocation of R87 billion for free-fee higher education and training.
- Contingency reserves have been revised upwards to R26 billion over the next three years.
- Real growth in non-interest expenditure will average 1.8 per cent over the next three years. Post-school education and training is the fastest-growing category.

MACROECONOMIC OUTLOOK - SUMMARY

<table>
<thead>
<tr>
<th>Percentage change</th>
<th>2017 Estimate</th>
<th>2018</th>
<th>2019</th>
<th>2020 Forecast</th>
</tr>
</thead>
<tbody>
<tr>
<td>Household consumption</td>
<td>1.3</td>
<td>1.7</td>
<td>1.9</td>
<td>2.3</td>
</tr>
<tr>
<td>Gross fixed - capital formation</td>
<td>0.3</td>
<td>1.9</td>
<td>3.3</td>
<td>3.7</td>
</tr>
<tr>
<td>Exports</td>
<td>1.5</td>
<td>3.8</td>
<td>3.4</td>
<td>3.5</td>
</tr>
<tr>
<td>Imports</td>
<td>2.7</td>
<td>4.4</td>
<td>4.6</td>
<td>4.5</td>
</tr>
<tr>
<td>Gross domestic product</td>
<td>1.0</td>
<td>1.5</td>
<td>1.8</td>
<td>2.1</td>
</tr>
<tr>
<td>CPI inflation</td>
<td>5.3</td>
<td>5.3</td>
<td>5.4</td>
<td>5.5</td>
</tr>
<tr>
<td>Current account balance (% of GDP)</td>
<td>-2.2</td>
<td>-2.3</td>
<td>-2.7</td>
<td>-3.2</td>
</tr>
</tbody>
</table>

TAX PROPOSALS

In 2018/19:
- The VAT rate will increase from 14 to 15 per cent from 1 April 2018.
- R6.8 billion will be raised from partial relief for bracket creep.
- Increases in the general fuel levy and alcohol and tobacco excise duties will together raise revenue of R2.6 billion. Ad valorem excise duties for luxury goods, such as motor vehicles, will be increased.
- Estates above R30 million will now be taxed at a rate of 25 per cent.
- The plastic bag levy, motor vehicle emissions tax and the levy on incandescent light bulbs will be raised to promote eco-friendly choices. A health promotion levy, which taxes sugary beverages, will be implemented from 1 April 2018.

CONSOLIDATED GOVERNMENT EXPENDITURE BY FUNCTION, 2017/18 - 2020/21

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Learning and culture</td>
<td>323.1</td>
<td>351.1</td>
<td>385.4</td>
<td>413.1</td>
<td>8.5%</td>
</tr>
<tr>
<td>Health</td>
<td>191.7</td>
<td>205.4</td>
<td>222.0</td>
<td>240.3</td>
<td>7.8%</td>
</tr>
<tr>
<td>Social development</td>
<td>234.9</td>
<td>259.4</td>
<td>281.8</td>
<td>305.8</td>
<td>9.2%</td>
</tr>
<tr>
<td>Community development</td>
<td>183.5</td>
<td>196.3</td>
<td>210.5</td>
<td>227.1</td>
<td>7.4%</td>
</tr>
<tr>
<td>Economic Development</td>
<td>183.5</td>
<td>200.1</td>
<td>211.9</td>
<td>227.1</td>
<td>7.4%</td>
</tr>
<tr>
<td>Peace and security</td>
<td>195.7</td>
<td>200.8</td>
<td>213.6</td>
<td>227.7</td>
<td>5.2%</td>
</tr>
<tr>
<td>General public services</td>
<td>62.1</td>
<td>64.0</td>
<td>65.9</td>
<td>70.5</td>
<td>4.3%</td>
</tr>
<tr>
<td>Payments for financial assets</td>
<td>20.4</td>
<td>6.0</td>
<td>6.2</td>
<td>6.6</td>
<td></td>
</tr>
<tr>
<td>Allocated expenditure</td>
<td>1 394.8</td>
<td>1 483.1</td>
<td>1 597.3</td>
<td>1 718.1</td>
<td>7.2%</td>
</tr>
<tr>
<td>Debt-service costs</td>
<td>163.2</td>
<td>180.1</td>
<td>197.7</td>
<td>213.9</td>
<td>9.4%</td>
</tr>
<tr>
<td>Contingency reserve</td>
<td>–</td>
<td>8.0</td>
<td>8.0</td>
<td>10.0</td>
<td></td>
</tr>
<tr>
<td>Consolidated expenditure</td>
<td>1 558.0</td>
<td>1 671.2</td>
<td>1 803.0</td>
<td>1 941.9</td>
<td>7.6%</td>
</tr>
</tbody>
</table>

TAX REVENUE 2018/19

- R505.8 bn Personal income tax
- R348.1 bn VAT
- R231.2 bn Corporate income tax
- R97.4 bn Customs and excise duties
- R84.8 bn Other
- R 77.5 bn Fuel levies
In a nutshell: Executive summary of 2018 National Budget

CAPE TOWN — South Africa’s new president Cyril Ramaphosa might not have been directly responsible for the deployment of the person who delivered today’s Budget Speech, but his fingerprints are all over the document. The text comes from a different universe to the flowery waffle Zuma-appointed finance minister Malusi Gigaba indulged in during his October mini-Budget address.

Like Donald Trump in Davos, Gigaba’s address was tightly scripted – this speech is all business. That’s reflected by its length – 8,800 words – which, despite it dealing with far more substantive issues than October’s mid-term address, is around 1,000 words shorter. Also, instead of the emotive rhetoric that punctuated the Zuma era, this one is on point, rational, professional.

As heartening, there are only two oblique mentions to Radical Economic Transformation – one in reference to “deconcentrating the economy” through greater competition, and the other relating to the creation of opportunities for black agricultural producers. A new age has truly dawned. Here’s the executive summary. – Alec Hogg
• New taxes will be introduced to raise R36bn. On the other side of the bookkeeping statement, the annual cost cutting programme introduced by Pravin Gordhan in 2016 to save 5% a year (R25bn) through consolidating State procurement, has been written in concrete this year. As a result, the 2018/19 Budget deficit is projected to fall from 4.3% to 3.6%.

• The largest reallocation of State resources is R57bn to fund fee-free higher education over the next three years. It will be phased in, starting this year with free tertiary education for first year students from households that earn less than R350 000pa (75% of taxpayers).

• The lion’s share of the coming year’s additional tax of R36bn will be generated by an increase from 14% to 15% in VAT, which will generate R22.9bn. This is the first time in the democratic South Africa that VAT has been raised, the last increase coming in 1993. VAT’s share of total revenue rises to 25.9% from last year’s 24.7%.

• Estate duty tax is raised to 25% for estates of greater than R30m. This will raise R150m in fresh taxes.3

• The excise duty on luxury goods is raised from 7% to 9%. This will raise an additional R1bn for the fiscus.

• Spending on education is the fastest growing spending category, rising 13.7% annually. Over the next three years R32bn will be invested in building and upgrading schools; R22bn in feeding 9m learners at 19 800 schools; and R3.8bn will go into providing water and sanitation for 325 and 286 schools respectively.

• Over the medium term, the National Health Insurance project will receive an additional R4.2bn funded through a reduction in tax benefits on medical expenses.

• New country-by-country reporting, in line with G20 recommendations, are being introduced which will help to address tax base erosion by multinational companies through transfer pricing.

• Treasury is investigating ways in which companies reduce their tax liability through excessive interest deductions.

• A total of R1.2bn in new revenue will be raised through a higher fuel tax. The price of petrol and diesel will rise by 52c a litre; 30c/l for the general fuel levy. Sin taxes will be increased between 6% and 10% raising R420m (tobacco) and R910m (alcohol) respectively.

• A total of R3bn will have been collected by end March from over 2 000 applicants for off-shore wealth amnesty through the Special Voluntary Disclosure Programme.

• Online sales to South Africans by foreign businesses will in future be liable to VAT.

• Six Special Economic Zones have been approved where companies will be enjoy reduced corporate tax rates and employment tax incentives.

• Carbon Tax will be implemented on 1 January 2019, based on a principle of polluter-must-pay.

• Overall government spending will increase from R1.56 trn to R1.67trn in the year ahead. It is projected to rise at a real rate of 2.1% in the next three years.

• South Africa’s economy is anticipated to grow by 1.5% in 2018 after 1% in 2017 (raised from the 0.7% anticipated in October’s Mini Budget.)

• The consolidated Budget deficit for 2017/18 was 4.3%. This is slightly lower than what was expected in October as higher economic growth led to a R2.6bn improvement in revenues, narrowing the revenue gap to R48.2bn from October’s expected R50.8bn.

• Old age grants will increase by R90 to R1 690 in April and to R1 700 in October. The child support grant rises to by R20 to R400 in April and to R410 in October. This will cost a total of R2,6bn.
• Social spending will increase 7.9% a year.

• The Department of Agriculture is re-prioritising R581m of its Budget allocation over five years to support a black producer commercialisation programme for 450 farmers.

• The Department of Rural Development and Land Reform will accelerate restitution claims with plans to settle 2 851 of these worth R10bn. A further R4.2bn has been set aside to acquire R4.2bn for 291 000ha of ”strategically located land.”

• An allocation of R6bn has been set aside for provincial and local government to assist with drought relief.

• A property audit conducted by the Department of Public Works shows that national government owns 195 000 properties worth over R40bn. A programme will be implemented to “better utilise of dispose of” the properties. It will also review all rental and property leases in an effort to cut costs.

• The new Twin Peaks authorities will be established “on or soon after” 1 April 2018.

• The finmin welcomed back Old Mutual, which is shifting its primary stock exchange listing from London to Johannesburg. He added his voice to calls for retribution for the Steinhoff accounting fraud, saying SA regulators are working with foreign counterparts to ensure “those at fault are made to account for their crimes.”

• Offshore allocation limits for institutional investors are increased by five percentage points across all categories.

• The Financial Services Board has been directed to “proceed with measured to modernise and improve the governance” of all retirement funds, including the requirement that they must now submit financial statements every year.

• Government will be reviewing all of its open-ended, “evergreen” contracts to open up opportunities for SMMEs and black owned companies to participate; and next week all departments will be instructed to pay suppliers on time “or be charged with financial misconduct.”

• South Africa’s Budget remains one of the most transparent on earth and was ranked joint first (with New Zealand) in the 2017 Open Budget Survey.
Latest 2018/19 tax tables: Just 3.7% of taxpayers footing 40% of SA’s bill

JOHANNESBURG — National Treasury notes that this year there will be no fiscal drag relief. As a result, an effective R14bn extra tax burden will fall on those earning over R410 000 a year. Subsequently, 270 000 people will generate 40% of SA’s personal income tax. Below are the latest tax details for the year. – Gareth van Zyl

<table>
<thead>
<tr>
<th>Taxable income (R)</th>
<th>2017/18 Rates of tax</th>
<th>Taxable income (R)</th>
<th>2018/19 Rates of tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>R0 - R189 000</td>
<td>18% of each R1</td>
<td>R0 - R195 050</td>
<td>18% of each R1</td>
</tr>
<tr>
<td>R189 081 - R296 540</td>
<td>R34 178 + 26% of the amount above R189 080</td>
<td>R195 851 - R305 850</td>
<td>R35 253 + 26% of the amount above R195 850</td>
</tr>
<tr>
<td>R296 541 - R410 460</td>
<td>R61 910 + 31% of the amount above R296 540</td>
<td>R305 851 - R423 300</td>
<td>R63 853 + 31% of the amount above R305 850</td>
</tr>
<tr>
<td>R410 461 - R555 600</td>
<td>R97 225 + 36% of the amount above R410 460</td>
<td>R423 301 - R555 600</td>
<td>R100 263 + 36% of the amount above R423 300</td>
</tr>
<tr>
<td>R555 601 - R708 310</td>
<td>R149 475 + 39% of the amount above R555 600</td>
<td>R555 601 - R708 310</td>
<td>R147 891 + 39% of the amount above R555 600</td>
</tr>
<tr>
<td>R708 311 - R1 500 000</td>
<td>R209 032 + 41% of the amount above R708 310</td>
<td>R708 311 - R1 500 000</td>
<td>R207 448 + 41% of the amount above R708 310</td>
</tr>
<tr>
<td>R1 500 001 and above</td>
<td>R533 625 + 45% of the amount above R1 500 000</td>
<td>R1 500 001 and above</td>
<td>R532 041 + 45% of the amount above R1 500 000</td>
</tr>
</tbody>
</table>

Rebates
- Primary: R13 635
- Secondary: R7 479
- Tertiary: R2 493

Tax threshold
- Below age 65: R75 750
- Age 65 and over: R117 300
- Age 75 and over: R131 150

Rebates
- Primary: R14 067
- Secondary: R7 113
- Tertiary: R2 574

Tax threshold
- Below age 65: R78 150
- Age 65 and over: R111 000
- Age 75 and over: R135 300

Source: National Treasury
Medical tax credits

Over the next three years, below-inflation increases in medical tax credits will help government to fund the rollout of national health insurance. Government will increase the medical tax credit from R303 to R310 per month for the first two beneficiaries, and from R204 to R209 per month for the remaining beneficiaries. The medical tax credit will be reviewed after the Davis Tax Committee presents its recommendations.

Table 4.7 Changes in specific excise duties, 2018/19

<table>
<thead>
<tr>
<th>Product</th>
<th>Current excise duty rate</th>
<th>Proposed excise duty rate</th>
<th>Percentage change Nominal</th>
<th>Percentage change Real</th>
</tr>
</thead>
<tbody>
<tr>
<td>Malt beer</td>
<td>R56.39 / litre of absolute alcohol (146.9c / average 340ml can)</td>
<td>R95.03 / litre of absolute alcohol (161.56c / average 340ml can)</td>
<td>10.0</td>
<td>4.5</td>
</tr>
<tr>
<td>Traditional African beer</td>
<td>7.82c / litre</td>
<td>7.82c / litre</td>
<td>–</td>
<td>–5.5</td>
</tr>
<tr>
<td>Traditional African beer powder</td>
<td>34.70c / kg</td>
<td>34.70c / kg</td>
<td>–</td>
<td>–5.5</td>
</tr>
<tr>
<td>Unfortified wine</td>
<td>R3.61 / litre</td>
<td>R3.91 / litre</td>
<td>8.5</td>
<td>3.0</td>
</tr>
<tr>
<td>Fortified wine</td>
<td>R6.17 / litre</td>
<td>R6.54 / litre</td>
<td>6.0</td>
<td>0.5</td>
</tr>
<tr>
<td>Sparkling wine</td>
<td>R11.46 / litre</td>
<td>R12.43 / litre</td>
<td>8.5</td>
<td>3.0</td>
</tr>
<tr>
<td>Ciders and alcoholic fruit beverages</td>
<td>R86.39 / litre of absolute alcohol (146.9c / average 340ml can)</td>
<td>R95.03 / litre of absolute alcohol (161.56c / average 340ml can)</td>
<td>10.0</td>
<td>4.5</td>
</tr>
<tr>
<td>Spirits</td>
<td>R175.19 / litre of absolute alcohol (R56.50 / 750ml bottle)</td>
<td>R190.08 / litre of absolute alcohol (R61.30 / 750ml bottle)</td>
<td>8.5</td>
<td>3.0</td>
</tr>
<tr>
<td>Cigarettes</td>
<td>R14.30 / 20 cigarettes</td>
<td>R15.52 / 20 cigarettes</td>
<td>8.5</td>
<td>3.0</td>
</tr>
<tr>
<td>Cigarette tobacco</td>
<td>R16.07 / 50g</td>
<td>R17.44 / 50g</td>
<td>8.5</td>
<td>3.0</td>
</tr>
<tr>
<td>Pipe tobacco</td>
<td>R4.56 / 25g</td>
<td>R4.94 / 25g</td>
<td>8.5</td>
<td>3.0</td>
</tr>
<tr>
<td>Cigars</td>
<td>R75.85 / 23g</td>
<td>R82.31 / 23g</td>
<td>8.5</td>
<td>3.0</td>
</tr>
</tbody>
</table>

Source: National Treasury

Table 4.4 Total combined fuel taxes on petrol and diesel

<table>
<thead>
<tr>
<th></th>
<th>2016/17</th>
<th>2017/18</th>
<th>2018/19</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>93 octane petrol</td>
<td>Diesel</td>
<td>93 octane petrol</td>
</tr>
<tr>
<td>General fuel levy</td>
<td>2.85</td>
<td>2.70</td>
<td>3.15</td>
</tr>
<tr>
<td>Road Accident Fund levy</td>
<td>1.54</td>
<td>1.54</td>
<td>1.63</td>
</tr>
<tr>
<td>Customs and excise levy</td>
<td>0.04</td>
<td>0.04</td>
<td>0.04</td>
</tr>
<tr>
<td>Total</td>
<td>4.43</td>
<td>4.28</td>
<td>4.82</td>
</tr>
<tr>
<td>Pump price&lt;sup&gt;1&lt;/sup&gt;</td>
<td>12.69</td>
<td>11.11</td>
<td>13.55</td>
</tr>
<tr>
<td>Taxes as percentage of pump price</td>
<td>34.9%</td>
<td>38.5%</td>
<td>35.6%</td>
</tr>
</tbody>
</table>

<sup>1</sup> Average Gauteng pump price for the 2016/17 and 2017/18 years. The 2018/19 figure is the Gauteng pump price in February 2018. Diesel (0.05% sulphur) wholesale price (retail price not regulated)

Source: National Treasury

The year of VAT and wealth #Budget2018
JOHANNESBURG — Amid the 2018 Budget Speech, South African taxpayers, especially the middle-to-higher income earners, are fast approaching the maximum levels of being taxed. This is according to Ferdie Schneider who is the National Head of Tax at BDO in SA. He says the country is already at a tipping point when it comes to personal income tax and that the risk to tax morality is growing. Here is the full interview with Schneider. — Gareth van Zyl

I’m Ferdie Schneider and I’m the National Head of Tax at BDO in SA.

Ferdie, thanks for chatting to me. We’ve just had the first VAT increase in 25 years, announced in last week’s budget. VAT is regarded as a regressive tax – so how will this increase impact the everyday South African, from the poor to the stretched middle-classes?

Gareth, if we were to believe Minister Gigaba when he read the Budget Speech, it will have a very small impact because there’s 19 food items that are subject to the zero-rating that’s supposedly covering the poor. In addition, there’s an increase in the grants to low income level people in SA as well. That’s the official message out there from the ministry. I think it is a bit more complicated than that. The zero-rated food items have been more or less static since the inception of VAT about 28 years ago. So, whether zero-rated items are really scientifically proven to assist the poor is a big question mark. I think there will be a very strong impact on the poor. However, I’m also not saying that the increase was wrong or the incorrect thing to do at the time.

Gigaba, then, was essentially between a rock and a hard place, in terms of that VAT increase.

Exactly, we needed about R51bn and then it got reduced to about R36bn. The VAT hike of one percentage point raises about R22.9bn. So, that brought us about two-thirds to closing the gap. I think the stress on the personal income tax and the high corporate tax rate left only VAT to be considered. If we had an efficient government — in the sense of State-Owned Enterprises (SOEs) and no waste — I think we wouldn’t have reached this point.

But it left us at this point, as a result of those various factors that I’ve just briefly mentioned.

It’s interesting if one looks at it because in terms of the breakdown in revenue, personal income taxes and VAT are going to be the two biggest revenue drivers, while corporate taxes are in a distant third. Are South Africans at risk of being over-taxed here, especially as
the unemployment rate is at record levels?

Yes, definitely. So, I’ve looked at some of the studies out there, specifically on the Laffer curve and whether we’ve reached that tipping point. Now, the Laffer Curve, as you would know, measures exactly the point where increases in tax rates actually decreases the tax take. My personal view is that we’ve reached that tipping point at the moment, and I would hope that the newly appointed Minister of Finance, Nhlanhla Nene will tackle the reduction and the overall tax burden in the next five years or so.

What about inflation? The inflation rate has been cooling off in recent times but could VAT risk pushing it up again?

Gareth, I don’t think so. I think it’s a very popular conception that an increase in the VAT rate raises inflation. I don’t personally think so. If you look at just the makeup or the calculation of inflation, it involves a consumer price index change from day one to day 366, over a 12-month period. So, if you increase VAT on day one, 1st April 2018, to 15% there’s no inflation technically, theoretically for the 12 months, even though the prices increase. The moment that you come up in financial media over recent days. It does look as if the moment it’s gone.

Yes, just looking at stealth taxes. It’s quite a popular phrase that has come up in financial media over recent days. It does look as if the trend in SA is that indirect taxes are on the rise. Do you think that that’s a fair thing to say?

Definitely. I think we’re raising roughly about 25% just on VAT at the moment. We’ve seen the fuel levy increase now yet again. And last year, when we still had a different Minister of Finance (it seems like we can say that every year), we heard an announcement that they will standard-rate fuel, whereas at the moment it’s zero-rated. So, I think there’s definitely a trend or shift away from direct taxes to indirect taxes, and I don’t think it’s necessarily a thought-through policy redirection. I think that’s all that’s left.

Just on that topic of the standard-rating of fuel. Can you explain what that involves exactly, and how it could impact SA?

Sure, so if you look at the current landscape, fuel is zero-rated. What that means to the average consumer is that the suppliers of fuel charge 0%, which is a theoretical VAT rate on the supply of fuel, which enables them to claim import tax reductions. So, by doing the 0% on fuel you’re actually removing all traces of VAT in the final consumption price. If you charge VAT at 14% on fuels however, my rough calculation showed that may increase revenues by about R1.8bn or R2bn perhaps. But my initial indication calculations show that that would raise an additional R18bn for the fiscus. They will not completely, I believe, remove the fuel levy but they will probably reduce it to the extent that there would be a tax expenditure of about R3bn, which leaves an additional R15bn. But I think with the shock now put on the general public by the increase in the VAT rate, they’re not going to repeat that statement of last year for a while.

So, do you think that it could be off the table?

Yes, I would guess it’s off the table for now. Gareth. And I think the only way that it can come back to the table is if growth expectations in GDP are not realised by this time next year. I think believing all things in the Budget – the GDP forecast as well, I don’t think we would need it next year.

Just on the topic of fiscal drag. So, that now only applies to the bottom three income levels. This seems like another form of stealth tax or indirect tax, especially for those earning, I think over R420 000 a year?

Yes, I think that’s a fairly new concept and it’s more prevalent in developing economies like SA with relatively high inflation rates. I think that’s become an instrument that National Treasury has been using to raise taxes. It’s almost like a VAT where you pay R114, now R115 almost, for an item, but you actually don’t realise there’s tip inside there, there’s VAT, and that’s the same with the bracket-creep type of adjustments, where they don’t adjust for inflation. I believe that they’re raising about R6bn this year on bracket-creep; this is after they’ve given away money in the first three or four brackets, the lower income brackets. But they’re taking it effectively from the top guys. What happens is that, of course, you get an inflationary increase if you’re in that grouping and then you just raise more tax. If you don’t adjust that for inflation there’s effectively that stealth tax in there.

Looking forward, you’ve spoken a little bit about Nhlanhla Nene, who
of course was named as SA’s new Finance Minister this week. Do you think that going forward taxpayers will bear more pain or do you think that things will get easier for them in the years to come?

Gareth, I also saw last night that they quoted a term ‘Ramaphoria’. So, I think whilst we’re in this ‘Ramaphoria’ we must capitalise on it. And with Nene there in Finance, I think the general feeling is that he is a very capable and able Minister of Finance. Then with Pravin going to Public Enterprises, I think South Africans can actually look forward to a turnaround in the next three years. I don’t think it will be easy in the next three years, because that would be part of a turnaround, in my view. But I would think we’ll turn in the next three years or so and we’ll see a favourable change in the next five years.

Well, at least there’s something to look forward to. There seems like there’s light at the end of the tunnel. Thanks for chatting to me today, Ferdie.

Gareth, thanks a mill. It was nice and I appreciated it.
Wealth and VAT: Two tax factors to watch in 2018 as Ramaphosa takes control

JOHANNESBURG — This Q&A with Stellenbosch Business School lecturer Lee-Ann Steenkamp provides a great explanation on how Finance Minister Malusi Gigaba’s tax changes will impact South Africa in the coming months. But with Gigaba potentially facing the chop from President Cyril Ramaphosa, the focus will also shift to how aggressively the country’s new finance minister will help drive home tax changes and even handle possible reforms. It truly is all hands on deck if there’s any hope of steering South Africa Inc. on the correct course again. – Gareth van Zyl

By Lee-Ann Steenkamp*

South Africa’s 2018 national budget came with a raft of tax increases indicating the country’s desperation to address a growing gap in its public finances. These include a hike in Value Added Tax from 14% to 15%. Sibonelo Radebe asked Lee-Ann Steenkamp to highlight the key tax developments.

What is your general impression of the budget speech?

I’m cautiously optimistic. In his own words, the minister of finance Malusi Gigaba noted this was a tough but hopeful budget. The budget speech echoed the theme of rebuilding and restoration set out in President Cyril Ramaphosa’s state of the nation address.

What is your impression around the key tax announcements?

Given the increases in personal income taxes in previous years major tax instruments have reached their limit in being used to raise revenue sustainably. As a result the minister only had two options to work with – focusing on wealth transfer taxes and Value Added Tax (VAT).

The result was that estate duty and donations tax rates were increased from 20% to 25% (with certain thresholds applying). And the VAT rate was increased from 14% to 15%. This won’t be a popular choice for the trade unions. But the Davis Tax Committee, set up by government to assess ways of improving the country’s tax policy, showed that a VAT adjustment would have the least detrimental effect on economic growth and employment over the medium term. In addition, the negative impact on poor households is mitigated by the zero-rating of basic foodstuffs.

What are the main drivers of the tax developments?

The tax proposals are designed to increase revenue collection. And the impending sugar tax (now called a health promotion levy) and carbon tax show that environmental and health considerations have begun to play a role in tax policy.

Overall, the tax policy measures are designed to raise R36 billion in additional revenue in the 2018/19 financial year. These measures are
aimed at reducing the budget deficit and funding fee free higher education and training for students from poor households.

Were there any missed opportunities from a tax perspective?

To create more certainty for tax planning it would have been helpful if the minister had explicitly said something about the introduction of a wealth tax. The Davis Committee looked into the efficacy of a wealth tax. The options would be charging it as a land tax, as an annual net wealth tax or as a national tax on the value of property (over and above municipal rates).

A wealth tax raised on the value of land would be complex. For example, it can’t be assumed that all private land owners are wealthy individuals. In the same vein, a national tax on the value of property would suffer similar shortcomings to an annual land tax. Thresholds would have to be used as well otherwise ownership would be used as a proxy for wealth.

An annual wealth tax would also be extremely complex and would probably lead to increased compliance and enforcement costs for the South African Revenue Services. This raises the question: would the cost be worth the additional tax revenue? We don’t know. What’s clear is that further in-depth research is required by the Davis Tax Committee, followed by a broad public consultation process.

At the very least the finance minister should have highlighted the issue in his speech. Policy transparency goes a long way in assuring investors (and taxpayers) that their money is in safe hands.

Any other thoughts?

The minister admitted that corrupt and wasteful expenditure by the government had eroded taxpayers’ trust in the state. This is a good starting point. But we’ve heard acknowledgements like this before, with very little (if any) progress afterwards.

The next few months will be crucial to see how the promises made by Ramaphosa will play out. Hopefully the governance and accountability of the South African Revenue Services will get immediate attention.

Lee-Ann Steenkamp is Senior lecturer, University of Stellenbosch Business School (USB), Stellenbosch University. This article was originally published on The Conversation. Read the original article.
#Budget2018: Curbing tax avoidance and clamping down on corporate covenants

By Marcus Botha and Sumayyah Pahad

The 2018 Budget Speech delivered by Minister of Finance, Malusi Gigaba on 21 February 2018 confirmed South Africa’s commitment to ending tax avoidance and its impact on economies and societies worldwide.

It was announced that the National Treasury, in close cooperation with the Reserve Bank, the Financial Intelligence Centre and the South African Revenue Service, are taking several steps to detect, disrupt and deter illicit financial flows including:

• Increasing capacity, coordinating a national risk assessment and improving information sharing between various agencies.
• The implementation and tightening of policy measures to deal with transfer pricing and base erosion by multinational companies in line with G20 recommendations.
• Country-by-country reporting enhancements that will ensure the fair share of tax is paid on South African source income.
• Investigating options to curb excessive interest deductions to reduce company tax liabilities.

In addition to the above, a clamp down on the following domestic corporate covenants has been announced to support the fight against tax avoidance:

• Debt relief rules in terms of section 19 and paragraph 12A.
• Share buybacks.
• Dividend stripping.
• Allowances granted to companies on debt funding to acquire qualifying controlling interest in operating companies in terms of section 24O.

These proposals have been left open ended and certainty is expected later in the year when the Tax Law Amendments Bill is promulgated.
Here’s what the analysts said on #Budget2018 – a mixed bag

JOHANNESBURG — Analysts have provided differing views on Finance Minister Malusi Gigaba’s Budget Speech on Wednesday. On the whole, many experts have welcomed government’s tough choices on VAT and other cost-cutting measures. However, concerns exist about where the growth will come from. Ultimately, it’s economic growth that will help solve many of the country’s woes, but, at the moment, faster growth is proving elusive. President Cyril Ramaphosa has a huge task on his hands in years to come. Below is a wide compilation of several analysts’ reaction to Budget 2018.

— Gareth van Zyl

Contrary to our expectations, there were virtually no cuts to overall expenditure over the medium term. Instead, there is a significant reprioritisation of spending in order to fund free tertiary education. This leaves considerable room to cut spending if President Ramaphosa’s planned merger of government departments proceeds. However, the wage increases currently being negotiated with public servants is critical – any slippage from the budgeted wage bills will derail this budget.

— Nazmeera Moola

By Nazmeera Moola, co-Head of Fixed Income, Investec Asset Management

By raising South Africa’s VAT rate from 14% to 15%, the South African government indicated a willingness to take difficult (and unpopular) decisions in order to stabilise the fiscus. Coupled with the recent change in the President, this Budget should be enough to keep Moody’s on hold when they release their South Africa sovereign review on March 22nd. If a good cabinet is appointed in the coming week, it may even be enough for Moody’s also to move the outlook to stable from negative. However, there are two concerns – firstly, that the debt-to-GDP profile does not stabilise for five years, and secondly, the public sector wage settlement that is still being negotiated.

Overall, Finance Minister Malusi Gigaba presented a plausible, conservative budget with reasonable growth assumptions that focuses on what it is delivering this year rather than making promises of future consolidation. Revenue hikes totalling R36bn are planned for the 2018/2019 fiscal year, anchored by the VAT increase, which will add a projected R22.9bn, and the zero relief for inflation in the top four tax brackets, expected to bring in a further R6.8bn.

In terms of the growth forecasts, the National Treasury’s assumption of growth at 1.5% for 2018 is at the bottom of the consensus range, and there is definite room for upside if half the structural measures announced in President Ramaphosa’s State of the Nation Address materialise.

The main budget forecasts remain higher than we would have preferred, with the primary balance, which excludes interest payments, only moving to zero in the 2020/21 fiscal year. Nevertheless, the improvements are still substantial. The 2018/19 forecast falls from 4.5% to 3.8% of GDP, while the 2020/21 forecast declines from 4.6% to 3.7% of GDP. However, if growth of 3% materialises by late 2020, this alone would move the main budget deficit to 3.4% of GDP in that year.

The improvement in the debt profile, driven by the higher revenue forecasts due to the VAT hike and higher growth forecasts, is encouraging. However, with the debt-to-GDP ratio only peaking in the 2022/23 financial year, we need to see further progress at the Medium Term Budget Policy Statement in October this year.
Ultimately, all our budget woes would be resolved if we could get growth going. For example, if we could achieve a growth rate of 3% in SA the 2020/21 fiscal year, it would push up the primary main budget balance by 0.4 percentage points. Indeed, it should not be out of reach and the Budget Review sets out a breakdown of how GDP growth of 4% could achieved. Assuming baseline GDP growth of 1.5% currently, the following factors could push it to 4%:

• Improved confidence: +0.5%
• Telecoms reforms: +0.6%
• Lower barriers to entry for small business: +0.6%
• Transport reforms: +0.3%
• Promotion of agriculture & tourism: +0.2%

The Budget was always going to be a necessary, but not sufficient condition to shoring up South Africa’s one remaining investment grade credit rating and restoring the confidence of households, investors and businesses in the economy. This Budget is good. In light of the political flux it was produced within, it is excellent. It demonstrates the depth of the skills and commitment of the Treasury staff.

The key now is whether the widely expected cabinet reshuffle puts people in charge of key Ministries that produce a regulatory environment that pragmatically encourages investment while taking into account South Africa’s social context. As the Treasury noted, a boost to confidence alone will raise growth by 0.5%. Sectoral reforms will do much more.

Structural reforms are the key to improving South Africa’s growth outlook. However, it is far more helpful if this takes place in the context of a competitive currency. In 2017, emerging markets experienced inflows of US$100bn into dedicated equity and bond funds. While flows in 2018 have been more volatile, the expectation is that they continue. Therefore it is very clever of the National Treasury and Reserve Bank to loosen exchange controls for institutional funds. The Budget Review noted that offshore limit for institutional funds is increased by 5 percentage points for all categories, including the African allowance. Therefore the African allowance goes from 5% to 10% and the Rest of World category for institutional funds goes from 25% to 30%. Total ex-SA allowance is raised to 40%. This allows savers to continue to diversify their holdings, while likely providing some offset to the likely inflows as South Africa’s potential growth rate rises.
PwC’s Tax Comments on the 2018 Budget Review: Indirect Tax

Charles de Wet, Head of Indirect Tax, PwC Africa

Increase in VAT rate

The Minister of Finance announced in his Budget speech that the VAT rate will be increased by 1% to 15% with effect from 1 April 2018. This increase is expected to raise additional revenue of R22.9 billion.

The result of the aforementioned increase, is that consumers will now pay an additional 1% tax on any purchases of goods or services from VAT vendors. This will have a major impact on households’ already tight budget. The implementation of the VAT increase for businesses may be complex, and the implementation date of 1 April 2018 does not leave much time to allow businesses to effect the necessary system changes and enhancements.

Updated regulation for foreign electronic services

The 2017 Budget Review announced that regulations prescribing foreign electronic services subject to VAT would be broadened to include cloud computing and other online services.

Updated draft regulations prescribing foreign electronic services and supporting amendments to the VAT legislation are to be published on Budget Day for public comment. It is disappointing that the regulations dealing with foreign electronic services have not kept up with international best practice.

Clarification on brown bread

Following recent uncertainty regarding the zero-rating of basic food items, government proposes an amendment to reflect the original policy intent that only brown bread and whole wheat brown bread will be zero-rated, and will not extend to rye or low GI bread.

Cryptocurrency

The VAT and Income tax treatment of cryptocurrencies will be clarified.

Insertion of the definition of “face value of a debt transferred”

A VAT-registered vendor is permitted to claim a deduction for VAT on taxable supplies that have to be written off. If the vendor cedes or sells the debt that has been written off on a non-recourse basis for an amount that is less than the amount owing, then the sale of the debt is exempt from VAT and the vendor is not required to make any adjustments to the previous VAT deduction. Certain vendors that buy book debt then attempt to claim a further VAT deduction if they write off all or part of this debt in future. This results in a double VAT deduction, which is against the intention of the legislation.

To prevent this double VAT deduction, it is proposed that the term “face value of a debt transferred” be defined in the VAT Act to take into account the policy rationale explained in the explanatory memorandum.

Postponing the abolition of the zero-rating of the supply of goods and services for the national housing programme

In 2015, amendments were made to the VAT Act to abolish the zero-rating of the supply of goods and services for government’s national housing
programme, with effect from 1 April 2017. In 2017, the legislation was amended to postpone the abolishment date for a further two years to 1 April 2019.

Due to budgetary constraints, it is now proposed to postpone the effective date for this amendment indefinitely.

CEO INITIATIVE REACTION TO BUDGET SPEECH

The CEO Initiative is encouraged by the steps taken in the Budget presented yesterday, aimed at achieving fiscal consolidation, balanced with the need to redress our country’s severe socio-economic shortcomings amid a low-growth economic environment.

“We realise the trade-offs and decisions could not have been easy with so many competing priorities, but given the severity of our challenges, we all need to sacrifice in some way to ensure the long-term stability of our fiscal position and avert further credit rating downgrades,” says Jabu Mabuza, Convenor of the CEO Initiative.

Fiscal consolidation

Going into this budget, South Africa’s most pressing crisis was to achieve fiscal consolidation, by addressing the unsustainable accumulation of debt, closing in on the fiscal gap and accelerating growth.

“In this regard we welcome the plans towards the stabilisation of debt-to-GDP to 56.2% by 2022/23 fiscal year, as well as the lowering of the consolidated deficit over the next three years to 3.5%. While there is room to reduce these elements further, we believe it is a positive start to improving our long-term fiscal outlook,” says Mabuza.

The downward revision of the expenditure ceiling is encouraging, and we particularly welcome the comments by the Minister of Finance regarding the need to rein in public sector borrowing, as well as the higher projections for GDP to 1.5% for this year.

“We acknowledge that the decision to increase VAT would not have been an easy one for any emerging economy in a time of low economic growth, but we commend the National Treasury for the bravery in taking the difficult decisions necessary for the long-term health of our country’s finances. This has been softened by an increase in social welfare spending and more inflation-adjusted tax relief for those taxpayers in the lower earnings brackets,” says Mabuza.

The CEO Initiative also commends the ongoing measures against corruption and wasteful expenditure in government departments and municipalities, such as supply chain management strengthening.

Commitment to enhancing growth

Over the past two years the CEO Initiative has been engaging labour and government on measures to improve economic growth in a sustainable and inclusive manner. In this regard, we welcome the prioritisation of expenditure towards growth-enhancing and employment-creating measures, such as small business development and infrastructure growth.

“The work on the SA SME Fund to support high-potential SMEs is in an advanced stage, and this aligns well with the government’s establishment of a R2.1bn fund aimed at supporting
small and medium enterprises during the early start-up phase.”

We also welcome the approval of six special economic zones which should enable greater investment and employment creation in the manufacturing sector.

“In addition to this, the CEO Initiative has engaged extensively with labour and government on measures to revive the manufacturing capacity in the Vaal Triangle,” says Mabuza.

Clarity on funding mechanisms of social programmes

“We are well aware of our country’s significant social challenges, and as such business supports the government’s objectives of expanding access to tertiary education, quality healthcare and comprehensive social security. However, we have always maintained that this has to be done in a responsible manner,” says Mabuza.

SOC reform

We welcome the Minister’s comments on the reforms required at state-owned enterprises, in order for these organisations to become self-sufficient and not dependent on the government for financial support and rescue.

“It is encouraging that the proposed measures go beyond mere bail-outs, but include equity investment, disposing of non-core assets and strategic equity partners,” says Mabuza.

The CEO Initiative remains committed to working with labour and the government in achieving sustainable and inclusive growth that benefits all who live in South Africa. We echo the comment by the president last week in the State of the Nation Address, as well as by the Minister in yesterday’s speech, that now is the time for everyone to lend a hand in rebuilding and strengthening our economy.

CHAMBER OF MINES NOTES BUDGET SPEECH

The Chamber of Mines welcomes the 2018/19 national Budget delivered today by Finance Minister Malusi Gigaba as a tough but necessary one that reinforces President Cyril Ramaphosa’s drive to stabilise the economy and get crucial sectors of the economy back on track.

The government had to make a set of tough choices on fiscal policy, and while the tax policy measures announced today may be painful, the Chamber is of the view that these are necessary to stabilise investment ratings in order to encourage investment going forward. In due course government will have to take steps to incentivise higher levels of investment through greater tax competitiveness compared with South Africa’s peers.

The Chamber welcomes the diagnosis on the difficult state of the mining industry, and the Minister’s reinforcement of the commitment expressed by President Ramaphosa in his State of the Nation address last week to allow parties the space to engage as part of a co-operative, multi-stakeholder effort to address the policy and regulatory uncertainty that has afflicted the industry in recent years.

The Chamber is looking forward to working with all stakeholders including government, organised labour and representatives of mining communities in formulating a social compact that will ensure the future sustainability of the industry and will allow the mining industry to achieve its full economic and transformational potential.
The budget speech also reinforced President Ramaphosa’s commitments to reviving the state-owned enterprises, whose decline due to poor governance and deep corruption have had serious impacts on the sustainability of the economy in general and our industry in particular.

Chamber members have indicated that should South Africa succeed in returning to the top 25% of mining jurisdictions in terms of regulatory attractiveness as outlined by the Fraser Institute, the country is likely to see an almost doubling of investment in the sector over the next four years.

This would have profound positive economic consequences, including the creation of 150,000 new direct and indirect jobs. All stakeholders must work together to develop a vision of what good looks like for the mining sector and agree to a social compact which will form the necessary foundation towards reviving and building a growing, vibrant and more transformed South African mining industry.

PAC COMMENT ON BUDGET 2018

The Budget speech confirms that the poor/landlessness are in need of a friend and that friend have been there for many decades, its PAC. That is why since its inception, the PAC has always been oppressed and suppressed by various institution, we are now silenced by Baleka Mbete as a Speaker by defying the wishes of the PAC to have our own representative in the legislature and not her favourite Luthando Mbinda.

The PAC notes the Budget speech as presented by Minister Malusi Gigaba in the National Assembly yesterday. The speech lacks an element of hope for the majority of poor landlessness African people in occupied Azania (SA).

The 1 percent increase of Value-Added-Tax (VAT) as proposed by the Minister is a sign of a war waged towards the poor citizens of our country. We are finding it absurd and laughable that the poor should be held liable for irresponsible, reckless corruption committed by the filthy rich politicians and tenderpreneurs.

It is a public knowledge that our state-owned-enterprises (SOEs) are ICU (Intensive Care Unit) with suggestion of other liberal opportunist to commercialise and privatize power supply, Eskom. Those opportunist liberal want the SAA also to be sold to private hands, PRASA is in a rubbish state that it is incapacitated to transport people to their workplace or students to their institutions. We are now told that government must
sell its Telkom stake so that they are able to save other entities, you rob Paul to pay Peter? The rapid decline of entities such as Steinhoff signals that greedy is at its highest point.

While we partially agree that President Ramaphosa’s State of the Nation Address was inspiring and promising a new country but the Budget speech negates and contradicts all that happened last week Friday. Ramaphosa promised the poor a better South Africa while Ramaphosa counter that by blowing the poor in the face.

The rich continue to be protected and prevented to pay for tax while our government have taken an anti-poor policy to tax and outstrip the poor every cent they happen to have. We are in a situation in the country where the employees are working for peanuts which only allows them to buy food and ticket for fare to work, our people are subjected to that for all their lives and they die poor.

The PAC is calling for the parliament to conduct a thorough investigation before they could adopt or bless this anti-poor budget. We are not going to allow a situation when the poor are continuously attacked through capitalist-oriented policies which seeks to take away everything from our people.

It is still clear to the PAC that that Budget was drafted and codified for the rich, it never talked even a sentence to the poor. There is no logic to say that you increase social welfare by less than R90.00 and yet you still increase their daily basic needs commodities, it is hooliganism.

OUTA: WHERE’S THE PLAN IN #BUDGET2018, MINISTER GIGABA?

Taxes are up again, but clear plans and interventions for the recovery of state-owned entities are missing.

Budget 2018

“The last few weeks have brought a new sense of hope to the country with the change in leadership and clear actions that signal the address of corruption and maladministration. However, Budget 2018 leaves OUTA concerned about the practical implementation of the promises,” says Ben Theron, OUTA’s COO.

OUTA is concerned that there is a significant increase in state spending — including an increase in the cost of the executive — but Minister Gigaba hasn’t given us a comprehensive plan to eliminate systematic corruption or even costed a budget yet for the already running commission of inquiry into state capture.

“Minister Gigaba is still trying to mislead society by conveniently spouting vague promises without giving clear action to implement...
them. The extension of guarantees in SOEs such as Transnet, Eskom and SAA, whilst necessary for stability, fails to address the plans to rebuild these institutions and stop future guarantees. The hints of privatisation of SOEs is encouraging and, in this regard, SAA should be disposed of as soon as possible."

Minister Gigaba has missed an opportunity to shed light on plans to get our economy growing again. The vague statements on the stabilisation of balance sheets of SOEs provide no certainty or confidence that further bailouts will be avoided. SANRAL is to be recapitalised, which underlines the failure of e-tolls.

OUTA is disappointed at the lack of clarity on Government’s commitment to reduce waste and eliminate underperforming programmes to address the deficit. OUTA is pleased to see that the Minister managed to find the money to get the free higher education promise started, but he seems to have forgotten that those students will soon need jobs.

The constant increase in personal income tax puts more strain on overburdened taxpayers. The plan to adjust medical aid tax credits to fund a very vague National Health Insurance plan will place taxpayers in a worse position.

"Taxpayers are sick and tired of seeing taxes increase year after year without material improvement in governance. Any increase in the tax burden on society is extremely frustrating against the backdrop of rampant maladministration and corruption," says Theron.

"We’re positive that President Cyril Ramaphosa will take state capture seriously and reduce corruption. As such, we see the Budget and tax increases as a necessary bitter pill to swallow, courtesy of Jacob Zuma and his ineffective Cabinet," says Wayne Duvenage, OUTA CEO.

"We trust that government will now be put to task to reduce spending and waste, in order to ensure there are no further increase in taxes in 2019."

OUTA intends to keep watch on the Budget promises and spending.

"Minister Gigaba, in your speech by saying we must fight corruption and maladministration. Lead by example and resign," says Theron.

BRAVURA HOLDINGS LIMITED: 2018 BUDGET RELIES ON INCREASED GROWTH PROSPECTS TO BALANCE THE BOOKS

Current Finance Minister Malusi Gigaba delivered South Africa's 2018 Budget in a more positive atmosphere given that Cyril Ramaphosa has been sworn in as State President last week. However, was he able to address the glaring revenue shortfalls, ever-increasing debt to GDP and threat of Moody’s following in the steps of Fitch and S&P Global with a downgrade of South Africa’s local debt to junk status?

Kemp Munnik, Head of Structured Solutions at Bravura, an independent investment banking firm specialising in corporate finance and structured solutions, comments that this Budget was keenly watched by local and international investors given the political change that took place recently, especially against the backdrop of the allegations of state capture. The 2018 Budget was essential to restore the credibility of the Annual Budget and the medium-term expenditure framework (MTEF).

The MTEF is significant because it provides insight into planned government expenditure and indicates expected tax increases that South African taxpayers have to face. It also informs decisions of the credit rating agencies about South Africa’s fiscal stability.

Revision of growth forecast

The South African economy has slowed down significantly in recent years. During the last quarter of 2016 and the first quarter of 2017 it even retracted into negative territory.

Gross domestic product growth of 1% is now expected for 2017, up from
The year of VAT and wealth #Budget2018

0.7% projected in October 2017. The National Treasury projects real GDP growth of 1.5% in 2018, 1.8% in 2019 and 2.1% in 2020.

The economy has benefited from strong growth in agriculture, higher commodity prices and, in recent months, improving investor sentiment and a stronger rand.

The global economy continues to provide a supportive environment for expanded trade and investment. World economic growth is at its highest level since 2014 and continues to gather pace. GDP growth is rising across all major economies. The global economic recovery provides a supportive environment for South Africa to expand trade and investment, but domestic constraints that have reduced business confidence stand in the way of accelerated growth.

Revenue shortfall and increase in taxes

There have been revenue shortfalls in four out of the past five fiscal years, mainly as a result of disappointing economic growth. The cumulative shortfall is about R60bn. The 2016/2017 shortfall was R30bn — the worst revenue performance since the global financial crisis.

Minister Gigaba has now announced a projected revenue shortfall of R48.2 billion in 2017/18, which is R2.6 billion less than the October 2017 estimate. He has therefore announced an increase in value-added tax from 14% to 15%. He will also maintain the top four personal income tax brackets with no inflationary adjustment to eliminate fiscal drag. These two measures will raise an additional R36 billion in 2018/19, enabling government to narrow the revenue gap.

China’s corporate income tax rate is 25%. While some African countries have similar or slightly higher tax rates, these are often effectively reduced with incentives and/or tax holidays.

The Budget Review recognises that South Africa is becoming an outlier, providing an unintended incentive for companies to shift profits abroad and pay lower taxes elsewhere. In recent years, government has taken steps to avoid erosion of the corporate tax base and prevent profit shifting, and to remove or redesign wasteful tax incentives. In addition to effective anti-avoidance legislation and adequate enforcement capacity, this requires policy decisions that do not undermine investment and competitiveness.

Recognition that corporate tax rate cannot be increased further

In a significant step, the 2018 Budget recognises that a corporate tax rate of 28% is affecting South Africa’s global competitiveness. The world experiences falling corporate income tax rates in advanced and middle-income countries. This trend limits the room to increase (or even maintain) the corporate tax rate. Corporate income tax contributes more as a share of GDP in South Africa than in most other countries. Within the Organisation for Economic Cooperation and Development (OECD), only companies in Chile contribute a higher share.

The global trend to reduce corporate income tax rates includes countries that maintain strong investment and trading ties with South Africa. The United States, for example has reduced its rate from 35% to 21%, the Netherlands from 26% to 21%, and the United Kingdom from 30% to 19%.

The 2018 Budget proposals will increase the gross tax-to-GDP ratio from 25.9% in 2017/18 to 27.2% in 2020/21. Social grant payments will increase faster than inflation to offset the effect of higher taxes on poor households.

Government debt

If government expenditure exceeds revenue, the difference must be borrowed, which adds to the level of government debt. This implies that the government’s burden on the economy (total government debt as percentage of gross domestic product) will increase. Certain economists have commented that SA has entered an unsustainable debt spiral.

The Budget Review recognises that increasing taxes in a low-growth context, when many South Africans are struggling to make ends meet, is not desirable. However, the fiscal position is substantially weaker than it was at the time of the 2008 financial crisis, when South Africa had a gross debt-to-GDP ratio that was just above 26%. That ratio now stands at 53.3%. A failure to act now would lead to more drastic spending cuts and tax increases in future.

Gross loan debt, which in the October 2017 projections was set to breach...
The year of VAT and wealth

The year of VAT and wealth #Budget2018

60% in 2021/22, is now projected to stabilise at 56.2% by 2022/23. The combination of higher GDP growth, a narrower deficit, a stronger currency and lower borrowing rates results in this improved debt-to-GDP outlook.

Expenditure cuts

In November 2017, in response to the deteriorating fiscal outlook, a Cabinet sub-committee identified medium-term spending cuts amounting to R85 billion. About R53 billions of this amount has been cut at national government level, including large programmes and transfers to public entities. At subnational level, conditional infrastructure grants of provincial and local government have been reduced by R28 billion. In addition, all national and provincial departments were required to reduce their spending on administration. The reductions exclude compensation of employees, which is already subject to a ceiling.

Recognition that cut in public sector wage bill is required

Government recognises the need to shift spending away from consumption towards capital investment.

To support higher levels of capital investment, the state needs to contain the public-service wage bill, which has crowded out spending in other areas. The level and rate of growth in remuneration is of concern. Cost-of-living adjustments that consistently exceed consumer price inflation continue to put pressure on departmental ceilings.

Improving the composition of spending will require renewed efforts by government to manage the public-service wage bill. According to the Organisation for Economic Cooperation and Development (2017), South Africa’s government wage bill is one of the highest among developing countries country peers. The consolidated wage bill increased rapidly from 32.9% of spending in 2007/8 and remains at about 35% of total expenditure in 2017/18. Departments will need to continue paying careful attention to managing headcount levels.

The 2018 Budget mentions that government is working to ensure that the current wage negotiations process results in a fair and sustainable agreement.

R57 million budgeted for free higher education and training

Over the next three years, more than half of government spending will be allocated to basic education, community development, health and social protection.

Funding for fee-free higher education and training will amount to additional spending of R57 billion over the medium term.

There is a provisional allocation in 2018/19 of R6 billion for drought management, assistance to the water sector, and to improve the planning and execution of national priority infrastructure projects.
The burden of state owned enterprises (SOEs) on the South African economy

The Budget recognises that the financial risks posed by the broader public sector remain significant. The Budget Review makes it clear that any additional commitment of public resources to state-owned companies will be associated with far-reaching governance and operational interventions – including, where appropriate, private-sector participation.

The following steps have already been implemented:

• A new board and acting chief executive officer have been appointed at Eskom.

• The Minister of Energy has instructed Eskom to conclude all power-purchase agreements with independent power producers.

• Government has granted South African Airways R10 billion to settle its short-term debt obligations. A new board, chief executive officer and restructuring officer have been appointed. A turnaround strategy is being implemented.

• Cabinet has approved a private-sector participation framework for state-owned companies.

• The Competition Commission’s market inquiry to investigate data prices will be complete by end-August 2018.

• Draft legislation is being prepared to allow Postbank to apply for a banking licence. The National Treasury and the Department of Telecommunications and Postal Services have met the Banking Registrar to discuss a Postbank structure.

Main tax proposals for 2018/19:

• A one percentage point increase in VAT to 15%.

• No adjustments to the top four income tax brackets, and below inflation adjustments to the bottom three brackets.

• An increase of 52c/litre for fuel, consisting of a 22c/litre increase in the general fuel levy and 30c/litre increase in the Road Accident Fund levy.

• Higher ad valorem excise duties for luxury goods.

• Increased estate duty, to be levied at 25% for estates above R30 million.

• Increases in the plastic bag levy, the motor vehicle emissions tax and the levy on incandescent light bulbs to promote eco-friendly choices.

Glimmer of hope?

The 2018 Budget is introduced as government has an opportunity to reinforce confidence and contribute to a recovery in growth and investment. A renewed sense of optimism is driven by the expectation that government will finalise many outstanding policy reforms, act decisively against corruption, and swiftly resolve governance and operational failures at state-owned companies. Investor sentiment has improved, leading to a strengthening rand exchange rate and lower government borrowing costs.

The rand strengthened significantly against the US dollar during 2017 and the first part of 2018, reaching R11.64/US$ today – a level last seen in 2014. The currency’s recent performance reflects investors’ reaction to domestic political developments, as well as overall strength in developing-country currencies. These currencies benefited from US dollar weakness, the search for higher yields by international investors and rising global commodity prices.
Recent events suggest an upturn in the business cycle. Statistics South Africa’s December 2017 economic statistics revealed an unexpected improvement in the economic outlook, largely as a result of growth in agriculture and mining. The SACCI business confidence index reached its highest level since October 2015 – and the Absa purchasing managers’ index its highest level since January 2010.

South Africa’s potentially stable macroeconomic environment provides a strong platform to attract much-needed foreign savings that can fund additional investment. The country’s prudent macroeconomic policies are highly regarded by international investors, as are its well-developed and well-regulated financial markets. If Budget 2018 stands as a commitment by government to practice sustained fiscal discipline, this could certainly steer South Africa’s economic fortunes in the right direction. We’re well advised to keep watching this space.

IRR: Budget 2018: Too little to restore growth

South Africa’s 2018 Budget might help avert an imminent downgrade, but the reprieve would be temporary unless President Cyril Ramaphosa and his Cabinet committed to a profound change in policy direction, according to IRR CEO, Frans Cronje.

The “medium-term expectation for South Africa to continue underperforming regional and emerging market growth averages by around 50%” was concerning, as current growth projections “will put paid to the prospect of a medium-term employment uptick”.

Cronje added that this “reintroduces risks of political instability, and presents a horizon for the Ramaphosa honeymoon”.

The question now was whether President Cyril Ramaphosa “can translate his political ascension into an economic reformation”.

Mr Ramaphosa and his Cabinet would have to “up their game” to make a compelling case for economic growth.

The VAT increase and fiscal drag measures “will place an even heavier burden on households and consumers, depressing domestic spending, and thereby undermining any effort at economic recovery”.

“Mr Ramaphosa has done well over the past eight weeks in raising confidence about the future of South Africa. However, if he is not able to validate and reinforce that confidence with a much more compelling case for reform, it will be in vain.”

Cronje said the Ramaphosa Cabinet’s agenda must include:

• Fundamental deregulation of the labour market to boost job creation;

• Replacing race-based empowerment measures that have largely benefited a politically connected elite but failed to help the poor with a policy directed at giving the masses of disadvantaged people the skills and opportunities presently denied to them;

• Selling off underperforming parastatals; and

• Securing property rights, without which little new fixed investment could be expected.
Clever tax planning: Using the retirement annuity as the new trust vehicle

I’m Ricardo Teixeira, Chief Operating Officer for BDO Wealth Advisers.

Ricardo, thanks for chatting to me today. The budget was delivered last week. Let’s just dive into some of the aspects that impacted individuals.

What are some of the key takeaways when it comes to income tax, estate duty, and donations tax?

Gareth, I think the starting point is that the fiscus has looked to raise revenue and close the deficit that we have within Treasury. And among the three taxes that you’ve alluded to that were impacted are income, capital, and estate duty taxes. Those changes have largely resulted in increasing the tax burden for the high net-worth individual. In addition, we now have a super tax rate bracket in SA, which is taxing individuals at the 45% that has remained unchanged as well. The brackets haven’t been adjusted for inflation and, as a result, any individual that earns a taxable income in excess of R500k is carrying a larger portion of the burden of the tax collection, going forward.

Then there’s also stealth taxes, such as the excise duty on luxury items and also the VAT increase.

That’s right, they’re looking at widening the tax collection for revenue and targeting a very small segment of the taxpayer population that is perceived to have the means to actually share more with the state. That’s really the essence of the concept of a wealth tax that’s been bandied about. It’s really trying to tax more from the few taxpayers that are able to contribute to the fiscus. Just to also take a step back, I think the good news is that capital gains tax has remained largely unchanged, year-on-year, and that is an element of wealth tax. It has proved to be quite a good mechanism for tax collection revenue. That has remained unchanged, so the inclusion rates haven’t changed, as well as the effective rates of capital gains.

The estate duty and donation tax changes I think were quite meaningful in that that they bring in an element of a wealth tax that, in essence, targets collecting more taxes from those who can afford it. Bringing it within the limit of the R30m mark indicates we’re moving in a direction whereby we recognise that wealthy individuals should be paying a higher burden of tax or should be contributing proportionately more to their affordability in raising revenue for the fiscus. So, those two changes are quite meaningful. I think the changes will impact on how wealthy families deal with their wealth in terms of transferring wealth between generations and between family beneficiaries. We may see that we’ll have regular donations to avoid reaching the R30m mark, and maybe even incurring a 20% donations tax at lower levels as opposed to waiting for a 25% tax on an estate, or higher in the future.
There’s also other vehicles like these 12J investments, which seems to becoming more and more popular. Do you think that taxpayers, especially in the wealthier brackets, will look increasingly towards those as well?

Correct, and our experience at BDO has shown that our clients are looking for solutions to be more tax efficient. However, as an individual, there’s not many options in terms of what one can look at in terms of being efficient in your tax affairs. So, allowances and opportunities, like investments in private equities, that do allow for a 100% deduction in year-one are very attractive. Naturally, from a wealth planning perspective, or looking at your investment strategy, there are other considerations around it other than just the tax. But the principle is very attractive and we are seeing an increasing momentum and trend towards considering those allowances.

Now, Ricardo, there’s also changes in the budget regarding Trust Attribution Rules and qualifying venture capital investments. What are some of the key takeaways from that?

What we’re seeing is that the Trust Attribution Rules actually were unaffected. So, Trust Attribution Rules really refer to what is largely termed the Contrary Principle, which allows for income and capital to flow through a Trust to a donor, as opposed to being trapped in a Trust. I think that is very attractive, if one considers having a Trust as a vehicle for effective planning and tax planning because it does allow for more efficient taxation of income and capital. If we really want to change the attribution rules, I think that would materially change the attractiveness of Trusts and how one can use it in family wealth planning. I think, right now, if we just pause and look at the effective tax rates – just looking at income, both in individual tax and a Trust. Pretty much, income is taxed on par — whether it’s tax within a Trust or an individual. However, if you’re looking at capital. Capital that’s trapped in a Trust is taxed at a much higher effective rate of about 36%, as opposed to the 18% in an individual on capital gains. Just that alone is quite an attractive arbitrage that is still available to individuals for their tax claiming purposes.

What about the wealth tax? That still seems like it’s on the horizon – do you think it could have a big impact in years to come?

Reflecting on the budget and reflecting on what levers revenue Treasury has available to actually close the gap. I think there’s not many. If we just focus on the revenue element to it – I think fiscus is caught in a very tough position right now where both individual tax rates, personal tax rates, as well as company tax rates, effective tax rates are at globally high levels. So, to start increasing the effective tax rate that an individual contributes towards Treasury and towards the revenue collection, we then risk getting to a point where you might be tipping the scales of tax morality. It then begs the question: If I’m going to be taxed so much, how do I look for options to limit that tax? That could drive behaviour, which would then decrease overall tax collection for Treasury and for the fiscus.

The concept of a wealth tax I think is banded about because of the fact that there is this growing gap between the haves and have nots, not only in SA but globally. I think the writing by Thomas Piketty has aided in that conversation about how the wealthy should pay a proportion to their affordability. But it does come a point where, in actual fact, it tips the scale in the opposite direction. I think that’s really where this concept of wealth tax is engrappled with by the Davis Tax Committee and their proposals to Treasury. So, the concept of wealth tax hasn’t been crystallised yet. But what we are seeing is definitely taxes on income, capital gains tax, Estate Duty, Transfer Duty of properties, and donations tax. These are five cornerstones of tax on wealth, and it’s those tax mechanisms that will form what we largely refer to as wealth tax. Therefore, another category of wealth tax could be very punitive for the taxpayer.
with those rates we could, you could have a situation where you would be incentivised to then channel your wealth and your income from personal hands into company hands.

In light of all of this, what are the options left for higher earning individuals, in terms of efficient tax planning in SA right now? It seems as if everybody is being squeezed.

Correct, you’ve mentioned one and that’s looking at tax deductions. So, investments into venture capital approved schemes are very attractive. They allow 100% deduction over five years. So, that would be an obvious one. I think a couple, which are less obvious, would be looking at realising your capital gains during your lifetime. Very often we find at BDO that clients are averse to realising capital gains on their investments that they’ve made over time. Yet, when you just stack up the numbers there’s a good argument to be taken advantage of the annual allowance, as well as the average rate of tax in any particular year, as opposed to deferring capital gains.

I think there’s one very key strategy we see and that’s donations tax, which I mentioned earlier. I think the different levels now of donations tax coming in at the R30m mark does create an incentive to use that, if your Estate does fall within that bracket. If you start looking at considering donations tax at a lower rate and saving the 5%. Another link to donations is that of interspousal donations between families. So, between spouses, donations are exempt, and that’s quite an effective way of spreading the tax burden or the tax base in a family.

Then the golden one and that’s the retirement annuity as the new Trust vehicle. In March 2015, the allowances were increased to allow for up to R350k of taxable income being allowed to be deducted for contributions to retirement funds, or 27.5% of your taxable income. That’s a great incentive in terms of tax planning, putting it into a retirement vehicle. Unfortunately, what’s very seldom understood by South Africans is the fact that their retirement annuity is a tax-exempt vehicle and all income earned, as well as capital gains, within the retirement vehicle actually are exempt during the term of that retirement annuity. It’s only really taxed once you convert it into a living annuity and you’re drawing a pension, but everything else is tax free.

Furthermore, the retirement annuity is protected from creditors so you have this mini-trust vehicle, which creditors can’t attack in the possible event of your insolvency. For an entrepreneur or a business owner, the retirement annuity actually would be quite an
attractive vehicle as opposed to a Trust for someone to actually create wealth, store wealth, and transfer wealth to their beneficiaries. My favourite is that retirement annuities are also exempt from Estate Duty so you land up shielding all four tax mechanisms that you really would use to collect revenue. You actually land up shielding your wealth in a retirement annuity.

That’s very interesting. So, in the age of passive investing and ETFs, are RAs then possibly overlooked?

They are, and often our approach at BDO has been to challenge our clients to look at retirement annuities in a different light. We’ve had instances where we have retired clients who are in their 80s, and are investing into retirement annuities. It sounds quite bizarre but when you actually run up the calculation or the numbers, and you look at the benefits of it – you still have access to your capital. You’re still transferring wealth to your beneficiaries, and you’re getting the tax deduction as well as shielding the taxability of that wealth, going forward.

Ricardo, just as a last question, we’ve had big Cabinet changes this week. We’ve got a new Finance

Minister, Nhlanhla Nene. How do you think that he will approach the hot topic of tax in years to come?

I do believe that under Cyril Ramaphosa, we would look proactively and intelligently look at how we can actually close the revenue gap, or the deficit that our country faces as a result of all the mismanagement that we’ve come through. When we look at the Minister of Finance Nene now coming into the role, I do believe that policies will be a lot more progressive. Maybe ‘progressive’ is not the right word but I think we’ll have smarter ways of collecting revenue, like we’ve seen with the VAT increase. I think it’s a very effective way of increasing revenue and spreading the load across SA, as opposed to targeting a single band. But I don’t envy his job because I do believe that it is going to be a challenging role. I think, in conclusion, I would say that largely it’s the policies that’s been set by leadership and by government which will, hopefully, be effective for us as a country.

Great, Ricardo, it’s been a fascinating discussion. Thank you so much for taking the time to chat to me today.

Lovely, Gareth. Thanks for the conversation.