

25 February 2019

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Parliamentary Standing Committee of Finance  
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By e-mail: Allan Wicomb, SCoF ([awicomb@parliament.gov.za](mailto:awicomb@parliament.gov.za))

Dear Sir

### **COMMENTS ON THE 2018 BUDGET REVIEW**

1. We present herewith our written submission on the 2018 Budget Review on behalf of the South African Institute of Chartered Accountants (SAICA) National Tax Committee
2. Our submission includes a discussion of the most pertinent matters we believe require the Committee's most urgent attention.
3. As always, we thank the Standing Committee of Finance (SCoF) for the ongoing opportunity to provide constructive comments in relation to the 2019 Budget. SAICA believes that a collaborative approach is best suited in seeking actual solutions to complex challenges.

Yours sincerely

David Warneke

Pieter Faber

**CHAIRPERSON: National Tax Committee**

**SENIOR EXECUTIVE: Tax**

*The South African Institute of Chartered Accountants*

#### **Attachments:**

Annexure A - Detailed submission



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## INTRODUCTION

### *Is there a “NEW DAWN”?*

*‘It will not be easy. There are no quick fixes. But our nation is ready for renewal. It is time for us to sow the seed of renewal and growth’*

4. These were the words spoken by Minister Tito Mboweni on 20 February 2019 in his maiden budget speech to introduce government proposed interventions. This theme was followed throughout his speech, where the Minister referred to setting South Africa ‘on a track to renewal’ with interventions to putting our country on a ‘bold new path’ and “sowing the seeds for renewal and growth”.
5. The question is, whether the planned interventions result in a “New Dawn” that we so desperately need to achieve a better South Africa for all?
6. The Minister built his speech on six fundamentals, namely:
  - 6.1 *Achieving higher rate of economic growth*
  - 6.2 *Increasing tax collection*
  - 6.3 *Reasonable, affordable expenditure*
  - 6.4 *Stabilising and reducing debt*
  - 6.5 *Reconfiguring SOE’s*
  - 6.6 *Managing the public sector wage bill*



7. The first question is, are the above the most important matters and indeed the fundamentals to be addressing?

8. In this regards, we can compare what SAICA and others have noted:

SAICA 2018	CEO Initiative	Rating Agencies
Unsustainably low economic growth	Improve growth and investment environment including fiscal policy	SA short on concrete policy (Moody's)
Low tax morality	Revenue collection including SARS capacity	Further erosion of fiscal strength (Moody's)
Public sector accountability	Spending discipline	Upwards trend of debt a risk to rating (Fitch)
Unknown and unquantified liabilities including SOE's, NHI and failing water and sanitation infrastructure	Reducing fiscal debt	SOE's debt liability without structural reforms (Fitch)
Education system	Public sector wage bill	Currency volatility (Fitch)
	Contingent liabilities at SOE's	Education system (Fitch)
	Public sector worker accountability	Possibility to reduce spending low (Moody's)
	Improved accountability of institutions like NPA to address wrong doing	
	Improving education	

9. The Ministers fundamentals for the budget are accordingly not in doubt and is aligned to what business and rating agencies are saying.



10. Even **President Cyril Rhamaphosa** is under no illusions as to what the main problems are as stated in his maiden SONA 2018 where he stated that **tough** decisions have to be made on:

- Closing the fiscal gap
- Stabilising debt; and
- Restore health of SOE's.

11. The reality is that we are as a country very aligned as to what our main problems are and this area deserves little debate.

### **Balancing Tough decisions**

12. It should from the beginning be clear that the decisions the Minister and us a country have to make are not between good and bad or easy and difficult, but rather a choice between the lesser of two evils. You cut public expenditure you may impact service delivery, you reduce head count you increase unemployment and skills loss, you increase revenue you decrease tax morality. These are not easy choices and though we may disagree with some of the choices and priorities, we have to acknowledge the burden in making them.

13. Furthermore, taking tough decisions in not just a perfect numbers game. The Chairperson of the Standing Committee on Finance, Honourable Carrim has on numerous occasions, including a recent past debate on the SA Customs Union payments, reiterated that perfect budget numbers can't be the only consideration when making tough decisions, especially if it imposes a burden too high on the people to bear.

14. Finding a balance between the "absolute truth" of the numbers and the burden imposed on the people, that will motivate others that we are doing the right thing and in fact moving in the right direction, is a fine line. The "how" is thus critical in informing this tough balancing act.

15. It is therefore the "how" that seems to be the biggest problem as this is the part justification for the choice. It is also unfortunately the "how" that is clearly missing from the Ministers Budget Speech.

16. Due to the lack of a "how", the Minister has proposed the same solutions as the previous 4 (practically 3) Finance Ministers before him since 2008 namely, increase debt, increase expenditure and announce incremental proposal to address the wage bill. This is a far cry from the 2005 Budget where Trevor Manuel tabled a budget seeking to reduce debt to 10% of GDP by 2009/2010.

17. Kicking the can down the road again and hoping for a miracle is not a "how" but deferring the responsibility of us as a country to take our future in our own hands.

18. So what are the high stakes in this poker faced decision-making-deferral game?

### **Gambling with the third strike – Junk downgrade**

19. A credit rating agency assigns a debtor a credit rating based on the debtor's ability to pay back debt by making timely payments of principle and interest and estimating the likelihood



of default. There are a few rating agencies of which there are three main ones, namely Moody's, S&P and Fitch. Below is a table explaining ratings of each of the 3<sup>1</sup>:

Moody's		S&P		Fitch		Equivalent to SVO Designations	Rating description			
Long-term	Short-term	Long-term	Short-term	Long-term	Short-term	NAIC				
Aaa	P-1	AAA	A-1+	AAA	F1+	1	Prime	Investment-grade		
Aa1		AA+		AA+			High grade			
Aa2		AA		AA			High grade			
Aa3		AA-	AA-	High grade						
A1		A+	A-1	A+	F1		Upper medium grade			
A2		A	A-1	A	F1		Upper medium grade			
A3	P-2	A-	A-2	A-	F2	2	Lower medium grade	Investment-grade		
Baa1		BBB+		BBB+					Lower medium grade	
Baa2		BBB		BBB					Lower medium grade	
Baa3	P-3	BBB-	A-3	BBB-	F3	3	Non-investment grade speculative	Non-investment grade AKA high-yield bonds AKA junk bonds		
Ba1	Not prime	BB+	B	BB+	B				4	Highly speculative
Ba2		BB		BB						
Ba3		BB-		BB-						
B1		B+		B+		5	Substantial risks Extremely speculative			
B2		B		B						
B3		B-		B-						
Caa1	CCC+	C	CCC	C	6	Default imminent with little prospect for recovery	In default			
Caa2	CCC									
Caa3	CCC-									
Ca	CC	D	/	/	/	/	/			
C	C									
/	/									

20. For many investors to consider withdrawing foreign direct investment, they mainly rely on all three rating agencies to give a unanimous rating, and for public bonds a non-investment grade rating i.e. to junk status.

21. A country therefore has 3 strikes before it is out of the investment grade circle and should be heeding the early calls. So where are we?

21.1 Strike ONE – Fitch downgrades SA to BB+ on 7 April 2017

21.2 Strike TWO – S&P downgrades SA to BB+ on 17 April 2017

21.3 Strike THREE – Moody's downgrades SA to Ba1 on **29 March 2019? (or will it?)**

22. We are therefore **ONE strike** (i.e. downgrade) from junk and Moody's remains concerned about our fiscal strength and real ability to contain expenditure. So are they just thumb sucking the risk of default and are we bean-counting and criticising too much?

<sup>1</sup> [https://en.wikipedia.org/wiki/Bond\\_credit\\_rating](https://en.wikipedia.org/wiki/Bond_credit_rating)



23. Below is a study on default rate vs rating in quantifying risk:

Estimated spreads and default rates by rating grade		
Rating	Basis point spread <small>[80][81][82]</small>	Default rate <small>[83][84]</small>
AAA/Aaa	43	0.18%
AA/Aa2	73	0.28%
A	99	n/a
BBB/Baa2	166	2.11%
BB/Ba2	299	8.82%
B/B2	404	31.24%
CCC	724	n/a

Sources: Basis spread is between US treasuries and rated bonds over a 16-year period;[23][81]  
Default rate over a 5-year period, from a study by Moody's investment service[83][84]

24. So from the data above, a +2 level investment grade rated creditors (SA's at its best in 2009) is 4 times more likely not to default than a -2 level sub investment grade creditors (where SA started in 1994) or one level below where we may be going on 29 March 2019. So that says a lot for how rating agencies see South Africa's credit worthiness. It also shows us the huge slide with SA having worked so hard to a receive its highest rating of A3 stable outlook in July 2009 and then just down from there with not much to show for the debt incurred. Our debt costs in 1999 was 5,6% of GDP, by 2005 it was down to 3,5% and now we are inching back to 5%. Minister Trevor Manuel on this historical progress said:

*"Members of the House will recall that debt service accounted for 5,6 per cent of GDP six years ago, and I know you will share my firm intent not to reverse this progress."*

25. Parliament has a duty to apply its own mind on the budget and since 2009 has much more authority to revise budgets which it views not in the interest of South Africa. It is therefore not a rubber stamp in the process.

26. It is pity that Parliament has since 2009 not provided more austerity rather than continually approving a perilous path down memory lane. We should also not forget that to make



these historical tough decisions, government had to in 15 years from 1994 defer many of our peoples dreams of a better life to settle debt, much of it not even of its own making.

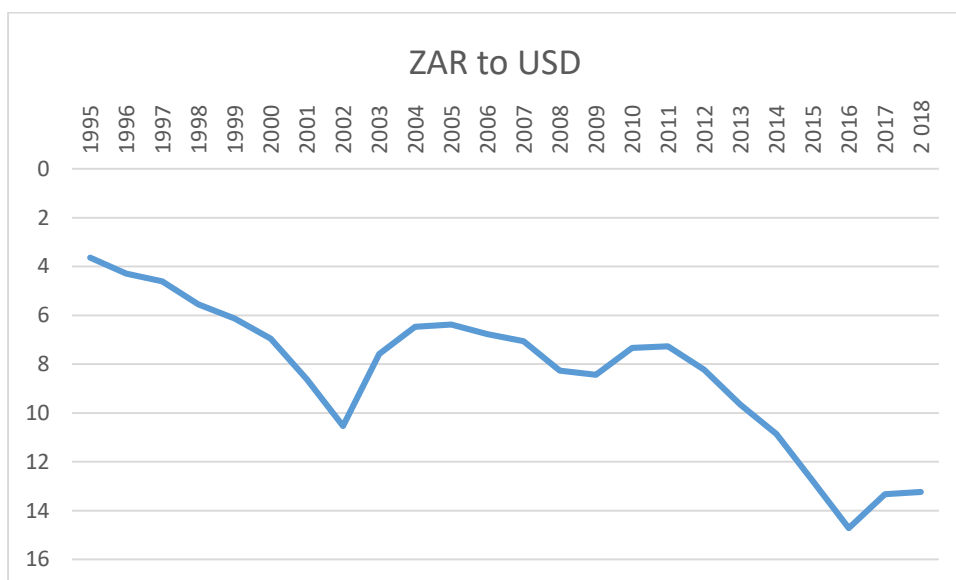
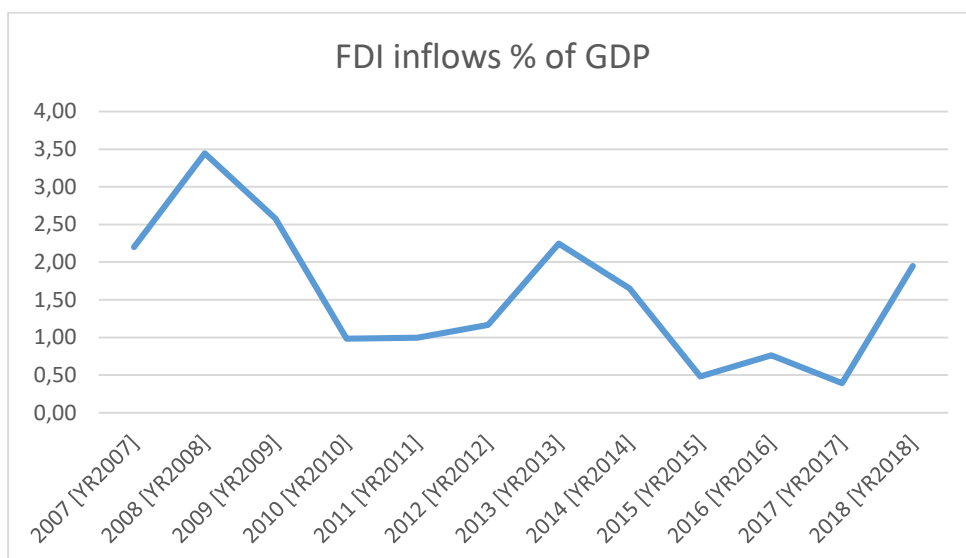
27. The lesser of two evils was chosen on the promise that their children and grandchildren would have a better and more secure life. A promise now not only deferred, but becoming less of a reality with each passing year.

## **BUDGET POLICY STATEMENTS**

### **Getting the fundamentals right for economic growth**

28. Policy uncertainty in all the fundamentals remains one of the biggest hurdles to economic growth.
29. Business find an environment with long term policy uncertainty a very difficult place to build sustainable business, jobs and contribute to economic growth.
30. **Policy uncertainty** was again a criticism of SONA 2019 as we share common views on the problems but seem to not share a common view on the future and how to get there.
31. Policy certainty is in many instances more important than the actual policy and government needs to do much more in expressing its plans on how it is going to address concerns.
32. In February 2018, the then Minister asked how we should increase economic growth. On analysing this the SAICA National Tax Committee also concluded that policy certainty remains a major challenge and that ad hoc interventions seemed counterproductive. They compiled what was presented to Parliament as the **SAICA SEVEN**.
  - Agreement of government's role in the economy as player and facilitator
  - Agreement on stable and peaceful labour relations
  - Currency stability
  - Quality and fit for purpose education
  - Policy stability and accountability enforcement
  - Reduction in crime
  - Agreement on infrastructure build priorities
33. Many of the above have been reiterated by ratings agencies as well as fundamentals and risks to growing our economy. The market also cares if South Africa can balance its books by securing long terms revenue growth and efficient sustainable spending. The confidence in our country and its ability to pay its debts is seeming followed by both Foreign Direct Investment and the currency as reflected below.
34. However it is also clear that very few if any economic drivers are contained in the fiscal policy framework, but rely on other portfolios.





35. As our debt grew worse and our economy slowed, investors starting also losing appetite to invest.
36. The President's interventions in the last year in speaking about driving change that makes SA business friendly has resulted in an upturn, but without the fundamentals being fixed, this upswing is just a **dead cat bouncing**.

### **Challenges in economic and revenue forecasts**

37. Revenue collection in relation to estimates continues to decline. As per the 2018/19 Medium Term Budget Policy Statement (MTBPS), the initial revenue shortfall for 2018/19 was estimated at R27.4 billion as compared to the 2018 Budget estimate.
38. The revenue collections shortfall has now increased to R42.8 billion compared to the 2018 Budget estimate – which represents an increase in the expected shortfall between October and now, by R15.4 billion.



39. National Treasury has attributed the shortfall to the economic weakness thereby resulting in lower than estimated corporate and personal income tax collections and poor tax administration.
40. It is interesting to note is that approximately half of the additional R15.4 billion shortfall has been attributed to the higher than expected VAT refunds. Taxpayers and tax practitioners will no doubt feel vindicated for their continued complaints that they have consistently raised in this regard over the last few years. However, the promised R20bn reduction in the VAT debt book (i.e. delayed refunds) in MTBPS 2018 did not occur and only half of that happened which means there is probably some explaining to do.
41. Our ability to accurately forecast our economic growth and the revenue it produces is of critical importance.
42. A worrying trend is that we seem to materially overestimate growth and revenue in the medium term, which when adjusted is not followed by an adjustment to expenditure.
43. This problem is compounded with what we now have confirmed by The Nugent Inquiry as SARS pre-collection practices, i.e. SARS retaining monies legally due and crediting it as collections or deferring it to its debt book. This practice to a large extent seems to have led to 3 years of narrowly “achieving” budget in 2014-2016.
44. This all started unwinding in 2017 with the Minister noting a R20bn adjustment required due to refunds. A further R20 bn was noted in the 2018 MTBPS as having to be released.
45. However, Treasury seem overly optimistic in medium term forecasts. Set out below is the medium term GDP growth forecast with the yellow the furthest and the bold the budget estimate after year end.

<b>ACTUAL</b>		<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018 Q3</b>		
		1,8	1,3	0,6	1,3	1,1		
<b>Budget</b>								
<b>Year</b>	<b>Calendar Year</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>	<b>2019</b>	<b>2020</b>
2019						<b>0,7</b>	1,5	1,7
2018					<b>1</b>	1,5	1,8	<b>2,1</b>
2017				<b>0,5</b>	1,3	2	<b>2,2</b>	
2016			<b>0,5</b>	0,9	1,7	<b>2,4</b>		
2015		<b>1,4</b>	2	2,4	<b>3</b>			
2014		2,7	3,2	<b>3,5</b>				
2013		3,5	<b>3,8</b>					
2012		<b>4,2</b>						
<b>OVERESTIMATION %</b>		133%	192%	483%	131%	118%		



46. For example, the end 3 year forecast for GDP growth for 2012 was 4,2%. This was adjusted downwards in each year to 1,4% in the 2013 Budget Review and the actual was 1,8%.
47. This led to 483% overestimation in 2016 compared to the medium term 3-year estimate.
48. It is not so much that Treasury is getting it wrong as GDP growth estimates are difficult by nature, it's that they are getting it very wrong and especially the trend is wrong. In the above Treasury had significantly overestimated GDP growth for 5 successive years even though it was very clear based on the actuals that they were being unrealistic. For example, growth estimates for 2018 were made in 2016 of 2,4%, even though 2016 growth was estimated at 0,5% and SA was on a multi-year down ward cycle.

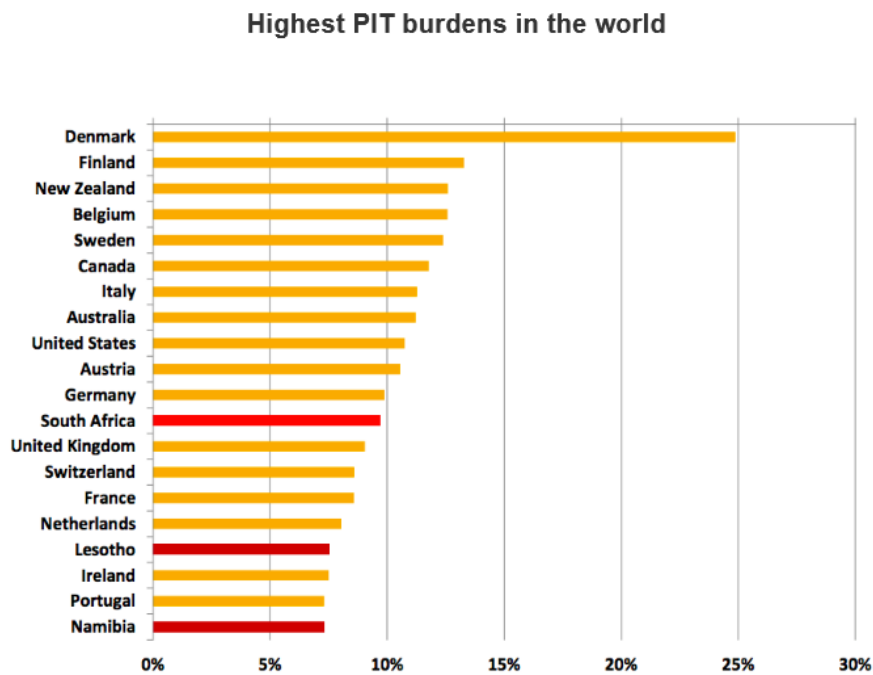
### **Revenue increases and tax burden**

49. The ongoing revenue shortfalls as well as additional expenditure, like the free higher education plan, resulted in significant tax increases over the last few years. We have seen increases in personal income tax rates, increases in the VAT rate as well as increases in dividends tax, capital gains tax (CGT), donations tax and estate duty (over certain limits).
50. Despite these measures raising an additional R99 billion in collective revenue over the last four years, tax revenue as a proportion of GDP has continued to decline. In order to limit the negative impact on economic growth, a decision was taken not to increase tax rates in any category. Instead, collections will be increased by not adjusting for inflation. It is felt that improved efficiency of tax administration will go a long way to improving collections overall.
51. In this regard it is estimated that revenue growth will increase from 6.6% this year to 8,4% which is quite optimistic given the minimal increase projected in GDP growth.
52. This budget essentially requires something very special from whoever is the new SARS Commissioner as the Minister believes much revenue ground can be recovered with an effective SARS. This view may be supported by the fact that tax buoyancy decreased despite tax increases.
53. This pressure may however continue incentivising the wrong behaviour for SARS officials in relation to compliant taxpayers.
54. The 2019/20 tax proposals are designed to address at least part of the revenue collections shortfall and are expected to result in an overall increase in collections which will raise an additional R15 billion in revenue. This is mainly attributable to R13.8bn gained from not giving inflationary relief on salary increases (i.e. bracket creep) and medical credits.
55. There is also a new carbon fuel tax which is estimated to raise R1,8 bn and this will continue to place a growing burden on transport costs where we have a rising fuel price and a depreciating rand. In total fuel will be increased by 29c for petrol and 30c for diesel.
56. There are also new taxes waiting in the wings which includes the carbon emissions tax, gambling tax and expanding the fuel levy to other fossil fuels like paraffin, LPS and



biofuels. In respect of the latter it is unclear how the poor will be protected who use these fuels for cooking and heating. Proposals will also be made for a host of new environmental taxes, water taxes and waste taxes. A possible tax as disincentive for exporting scrap metal would be positive but banning exports would probably bring a much more immediate end to the butchering of South Africa's infrastructure for cheap scrap exports and incentivize local industry.

57. What the above proposals seem to fail to acknowledge is that SA is already a high tax country and very little respite is given in this sense as seen below<sup>2</sup>:



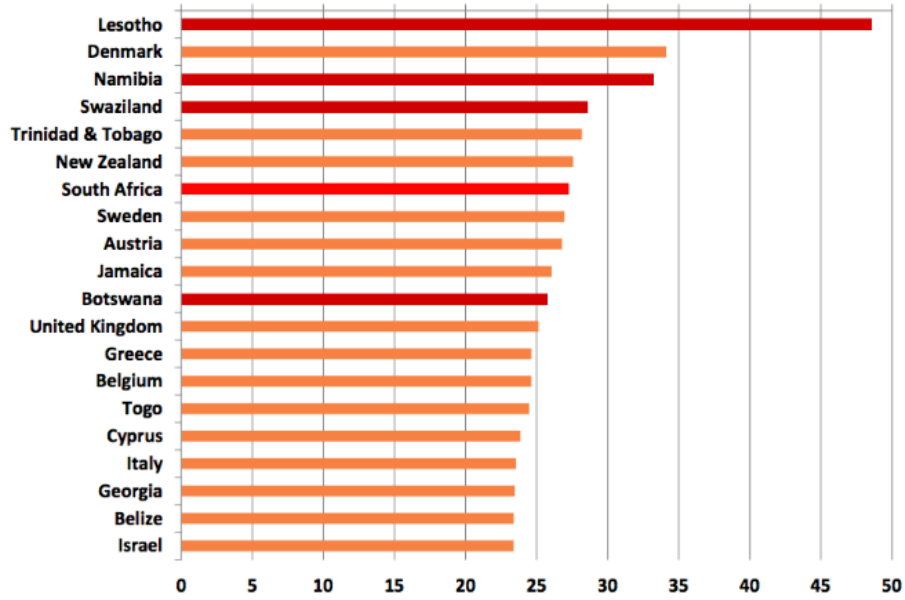
58.

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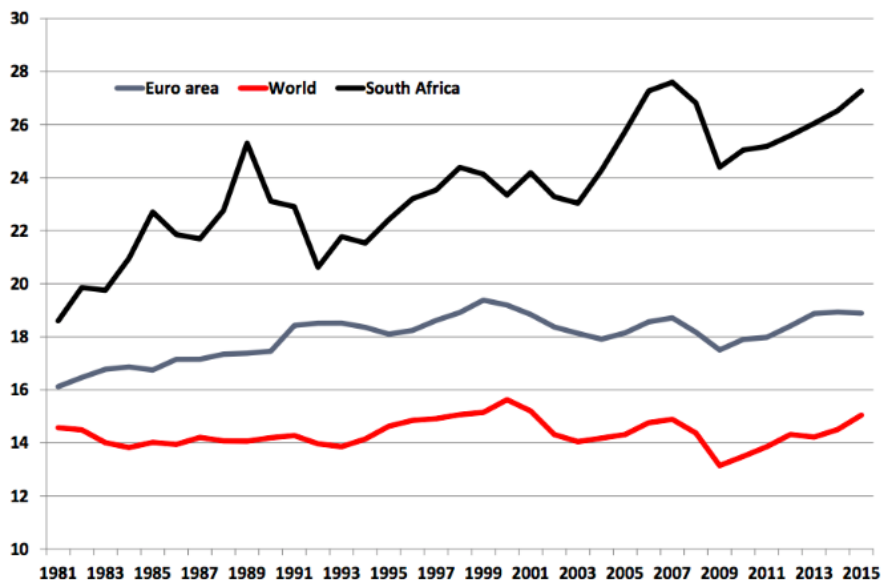
<sup>2</sup> <https://businesstech.co.za/news/finance/233199/the-highest-income-tax-rates-in-the-world-including-south-africa/>



### Total tax to GDP



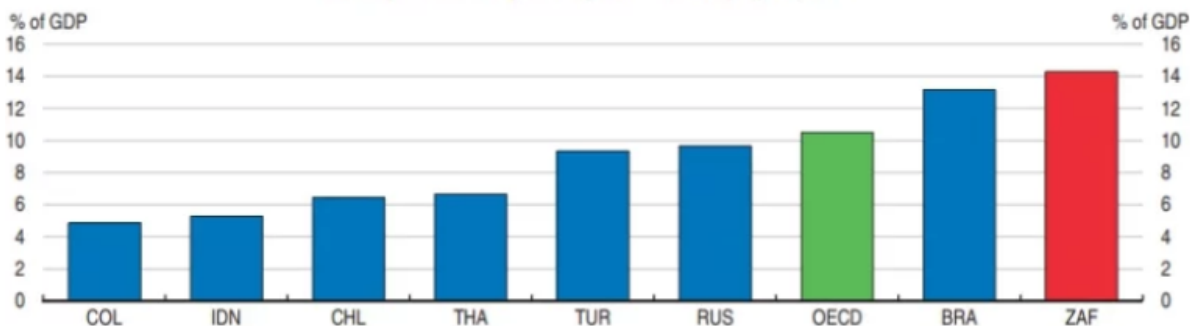
Total tax to GDP over time



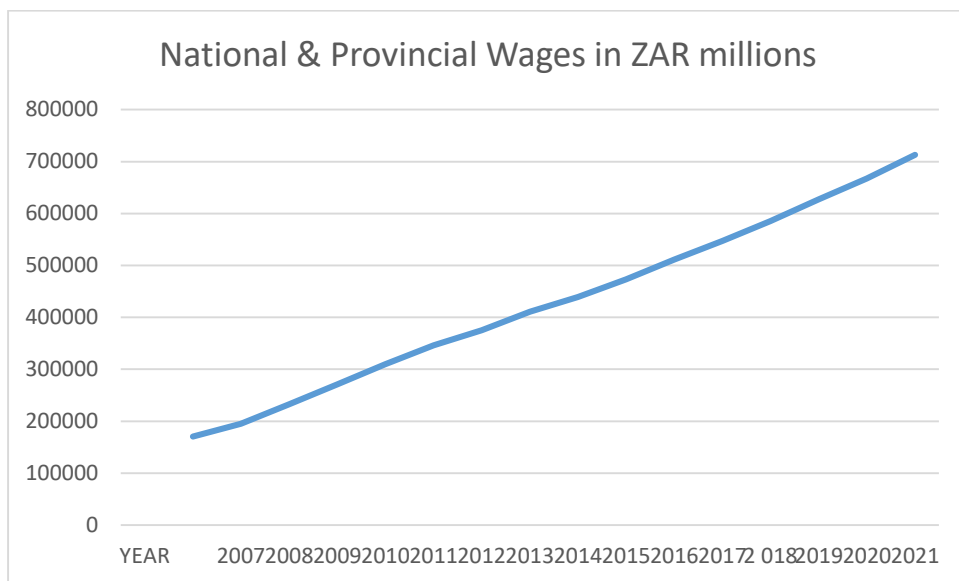
**Public sector wages**

59. The public sector wage bill continues to grow at nearly twice CPI at 9,3%. It is not just the annual increases but the overall burden of the wage bill, even compared to other countries<sup>3</sup> and this disparity has grown significant since 2015:

C. Compensation of general government employees, 2015



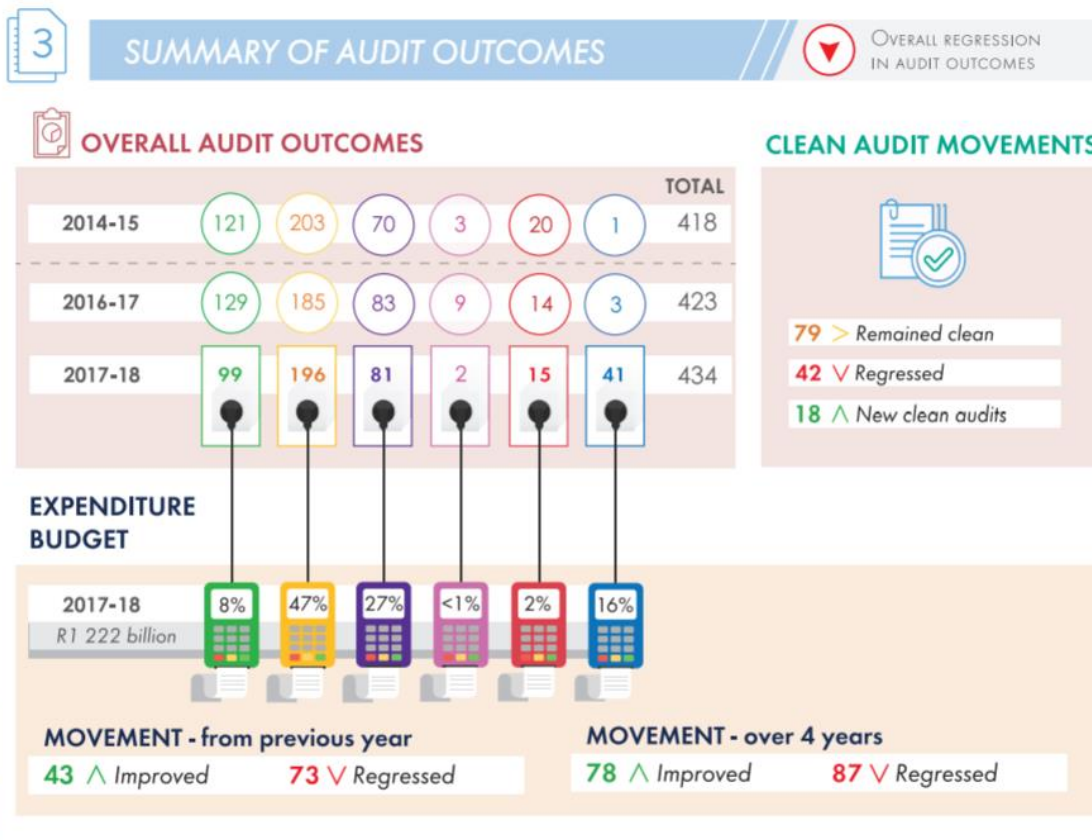
<sup>3</sup> <https://businesstech.co.za/news/business/192100/sa-governments-r137-billion-wage-bill-vs-emerging-economies/>



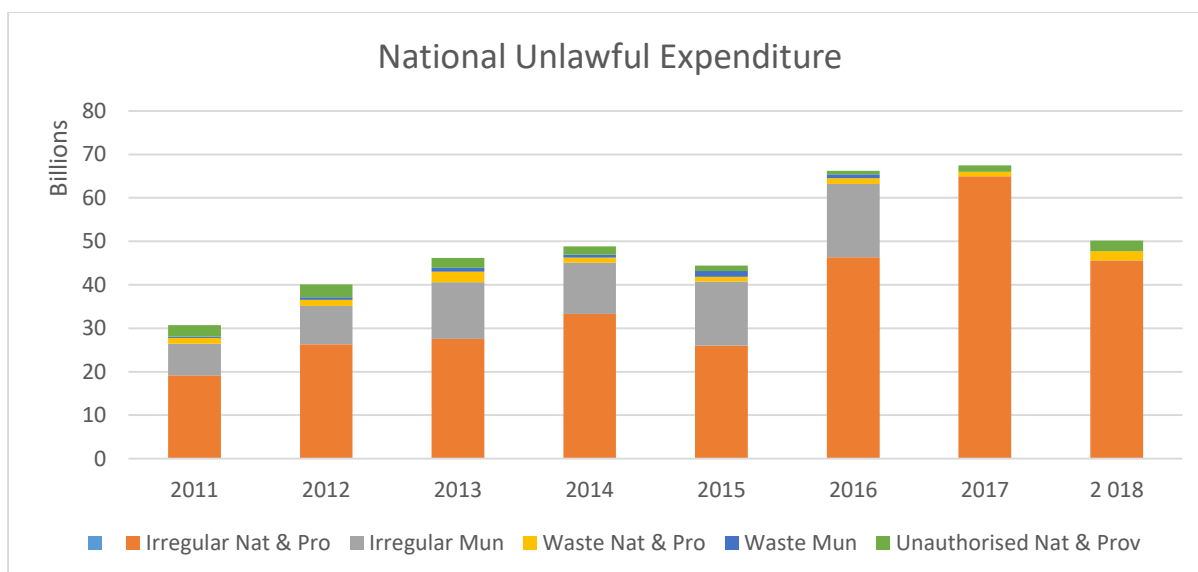
60. The Minister has noted these concerns, proposing to reduce head count through voluntary retirements.
61. Much concern is also appropriate given the Ministers proposals of normal attrition and early retirement as the only containment measures. These are usually the most skilled staff and having 5 young PA's and no old engineers is a recipe for disaster, like what happened at Eskom, SABC and municipalities who have followed similar practices before.
62. However, moving bonus to a per person performance management structure is a step in the right direction, it just needs to be expanded to all remuneration.
63. As was evident in the Ministers 2018 MTBPS, provincial government has a large slice of the wages cake and especially smaller provinces like the Eastern Cape have a staff / population ratio well above many other provinces.

**Lack of public sector accountability**

64. A number of inquiries are trying to unravel numerous instances of grand scale looting of the public purse.
65. However, it is clear that the day to day financial control activities in government leaves much to be desired and creates ample opportunity for abuse with consequence.
66. Below are the Auditor General 2018 findings on audit outcomes:



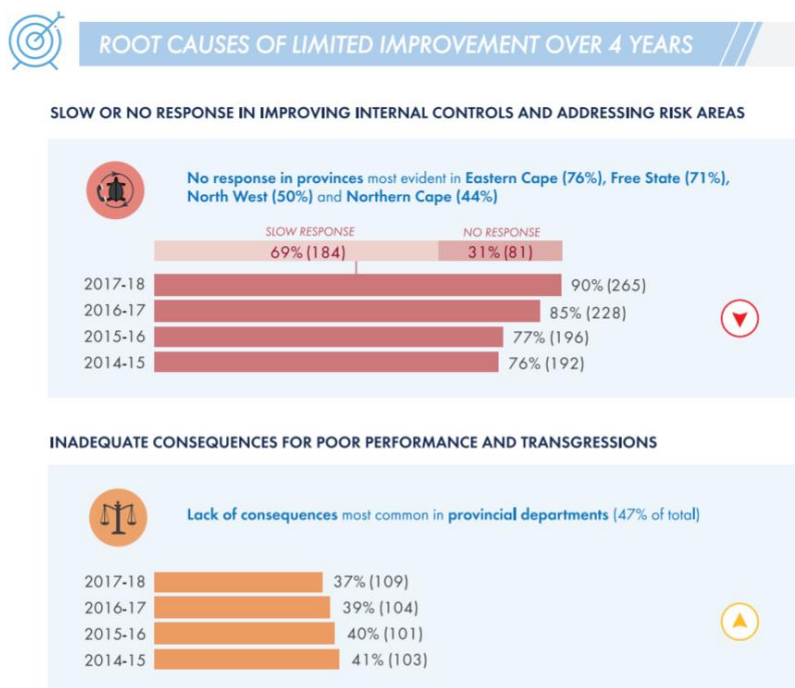
67. Regression is the order of the day and quite concerningly so, with even bastions of financial controls like SARS forming part of this statistic.





68. At National and provincial level governments efforts to reduce irregular expenditure by nearly R20bn must be commended. However, the fact that wasteful and unauthorised expenditure doubled in 2018 is worrisome as these transgressions are more serious.

69. The lack of accountability and consequence management is also alarming as noted below and it is growing:



## **SPECIFIC TECHNICAL MATTERS**

### **Policy of retrospective amendments without clarity**

70. The Minister has announced that in respect of certain dividend stripping avoidance arrangements amendments will be proposed back dated to 20 February 2019.

71. Though retrospectivity has been debated quite liberally in recent years, what has become more concerning is that Treasury, like in 2011 with section 45, make very unclear and broad statements which result in all similar commercial transactions being halted as there is too little information to decide whether your transaction is in scope.

72. This creates an untenable system with Treasury implementing a green, orange and red bucket system in 2011, arguably the green should have been excluded in the Budget already. Bucket systems don't work in SA irrespective of where they are used.

73. Treasury should ensure that it has sufficient detail and knowledge of the avoidance and what principles it would apply to ensure legitimate transactions can proceed without having to wait for the final legislation.



### **ETI threshold increases**

74. The President in 2018 approached business to employ more young people to give them experience and the challenge was accepted.
75. However, the ETI threshold increase of only R500 to R6500 is not enough to ensure that more young people are employed in semi-skill required sectors of the economy.

### **CFC High tax threshold**

76. The global average corporate income tax rate has been decreasing and is now at only 23,3%, 21% in EU countries and 23,69% in OECD countries.
77. Even countries like the UK will now be below the high tax exemption rate of 21% as they migrate to 18%.
78. This creates a very uncompetitive income tax environment for South African corporates who are doing business in what are normal tax rate countries but face anti avoidance legislation in South Africa.
79. The high tax threshold should be adjusted to align to the global corporate tax realities of decreasing rates.

