The 2018/2019 Budget Challenge

Johannesburg, 19 February 2018 - In the wake of the most rejuvenating State of the Nation (SONA) address this country has experienced in years, we now await the Minister of Finance's Budget Speech on 21 February 2018 to determine how all of the proposed initiatives will be funded.

According to Tracy Brophy CA(SA), Chairperson of the SAICA National Tax Committee, "The budget deficit for 2018/2019 was pegged at around R70 billion (bn) during the Medium Term Budget Policy Statement in October 2017, but that was before the announcement of free tertiary education (which the Minister of Finance indicated would be funded by reducing government expenditure and raising additional taxes of approximately R15bn). So, the actual budget deficit for 2018/2019 is more in the region of R85 bn, which is a substantial amount.

Therefore, all of the selected tax rate increases will need to be as broad based as possible and highly effective. There is no time for popular choices, only efficient ones.

An increase in the Value Added Tax (VAT) rate of 1 percent (%) to 15% is estimated to raise between R20bn and R30bn in revenue, which is in line with the global average of 15.64% and the African average of 15.25%. However, given that the President indicated in the recent SONA that the much-anticipated National Health Insurance (NHI) will be introduced (and it is commonly understood that a VAT rate increase would only be tolerated by the unions if used to fund the NHI), it is likely that more than a 1% increase is required to fund both the NHI and decrease the deficit. However, the Minister needs to tread carefully regarding the effective date of such a change, since industry will need time to respond and change their invoicing systems (since it is likely that certain systems have 'hard coded' the VAT rate at 14% and system development may be required to effect such a change). Of course, the Minister already indicated that the zero rating of fuel is being reviewed, which would mean immediate revenue at 14% on the price of fuel if this zero rating were to be repealed. However, if this option is enacted, it goes without saying that no further increases in the fuel levy should be sanctioned, in order to prevent double taxation on fuel purchases.

Even though the personal income tax (PIT) taxpayer base is small (it is estimated that around 80% of PIT is being paid by 25% of the PIT taxpayers), it would appear that this base remains a popular target for tax increases despite it arguably having reached the point of diminishing returns. A way of targeting this base

without adjusting the PIT rate any further is by increasing the existing so-called 'wealth taxes', i.e. estate duty (20%), donations tax (20%) and capital gains tax (CGT) (40% inclusion rate resulting in an effective rate of 18% for the top bracket which are taxed at 45%). Even though the Davis Tax Committee has only recommended an increase in estate duty to 25% and an increase in the CGT inclusion rate for corporates (from 80% to 100%), there is nothing preventing an increase to 25% for both estate duty and donations tax and an increase in the inclusion rate for CGT to either 50% or 60% (taking the effective CGT top rate to 22.5% or 27%).

In addition, there are donations tax 'windfalls' due during March 2018 as a result of the recent anti-avoidance section targeted at taxing low-interest or interest-free loans by PIT taxpayers to trusts (section 7C, which came into effect on 1 March 2017 and in terms of which market related interest, at the official rate of interest, is deemed to be a dividend on the last day of the trust's year end [28 February] and is payable by 31 March 2018), which means that an increase in the donations tax rate as at 28 February 2018 would bolster the donations tax revenue which is already due to be collected by 31 March 2018 (and 'raise the bar' for all future donations tax revenue collections in this regard). Once the donations tax rate is increased, the estate duty rate is usually equalised to ensure that there is no arbitrage between the two tax types.

The next 'easy win' against PIT taxpayers is to utilise 'fiscal drag' yet again (by not moving the tax brackets to take into account the effect of inflation), which means that when taxpayers receive an inflationary increase in their salaries and move into the next tax bracket, they surrender their shiny new salary increase to pay their increased tax burden. This was effectively instituted in 2017/2018 and is rumoured to have raised around R16bn in revenue. There is nothing stopping the use of fiscal drag again this year.

Given the President's desire to stimulate investment into the South African economy, together with the global 'race to the bottom' (which has seen numerous governments around the world reducing their corporate income tax (CIT) rates), it is unlikely that the CIT rate, at 28%, will be increased. It is also uncertain how much additional revenue would actually be raised as a result of such an increase, given the country's poor economic climate and severely limited economic growth forecast (less than a percent for 2017). However, the effectiveness of equalising the corporate CGT rate with the CIT rate (as mentioned above) is questionable, since the resultant increase in revenue may only be marginal and it will be achieved at the expense of industries such as insurance and private equity.

So, no matter what tax hikes the Minister of Finance announces on 21 February 2018, the impact on affected taxpayers (and the population at large if the VAT rate or the fuel levy is increased) is expected to be detrimental, despite the fact that such taxes are desperately needed by government. At this point, I am not prepared to entertain the 'tax morality' debate, since paying one's tax is not

debatable; it is mandatory. However, one can only hope that the tax revenues raised are utilised in support of all of the President's recent SONA plans, including the curbing of wasteful expenditure and corruption, so that all taxpayers can finally see the 'value add' by government ultimately culminating in economic growth and job creation as a result of their vital contribution."

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SAICA Media Contact

Kulani Chauke

Communication Coordinator: Corporate

SAICA Brand Division

011 479 0698

kulanic@saica.co.za

Subject Matter Specialist

By Tracy Brophy CA(SA)

Chairperson: SAICA National Tax Committee