Reimagine the possible
2018 budget predictions

Tax revenue estimates

2017/18 tax revenues

In the 2017 Medium-term Budget Policy Statement (MTBPS), estimates for 2017/18 tax revenues were revised downwards by R50.8 billion to R1 214.7 billion. The major contributors to the downward revision were personal income tax (R20.8 billion), VAT (R11.4 billion), customs duties (R5.4 billion) and corporate income tax (R4.8 billion).The downward revision to tax revenue estimates was, however, broad-based, with estimates for all tax types being revised downwards.

The good news is that the bad news is unlikely to get worse. Based on revenue collections to end December, we expect tax revenues for 2017/18 to be broadly in line with the MTBPS estimates and possibly slightly better, off the back of a good performance in corporate income tax collections in December and a strong recovery in import taxes since September.

2018/19 tax revenues

The 2017 MTBPS significantly reduced the medium-term estimated tax revenues for 2018/19 by R69.3 billion from the 2017 Budget estimate, to R1 315.1 billion. This estimate includes the additional tax increases of R15 billion announced in the 2016 Budget. The downward revision was a result of the base effects of the downward revision to the 2017/18 tax revenue estimates and a downward revision in the GDP growth forecast for the year. Importantly, this downward revision in gross tax revenues is partially offset by a reduction in the Southern African Customs Union (SACU) payments of R17.7 billion, resulting in a reduction in net tax revenues of R51.6 billion.

In this context, the President directed the Minister and National Treasury to further cut expenditure by R25 billion and create revenue-enhancing measures, including taxes, amounting to about R15 billion in order to stabilise gross debt below 60% of GDP. In light of this, it is expected that tax increases of at least R30 billion (comprising the 2016 announced increase plus the recent direction from the presidency) can be expected to be announced in the 2018 Budget. Given the announcement of free higher education, which was not factored into the MTBPS forecasts, it is possible that tax increases will be even higher in order to fund this initiative, although indications have been that it will be funded through reprioritisation of expenditure.

Similar considerations apply to the establishment of the NHI Fund, where the phasing out of medical tax credits is being considered. However, we do not expect that additional taxes will be raised at this stage specifically to fund the NHI initiative.

In light of the above, it is expected that the tax revenue estimates will be increased by a further R15 billion for 2018/19. Tax buoyancy ratios used in the MTBPS are expected to be maintained. With the real GDP forecast likely to be in line with that in the MTBPS and a likely lower forecast inflation rate, this will have a slight negative effect on the MTBPS revenue forecast, although this may be offset by a slightly better than forecast revenue performance for 2017/18.

Business

Corporate income tax

Tax rates

No change is expected in the general corporate tax rate of 28%. Any increases would negatively impact on the competitiveness of SA's tax rates (the global trend for corporate tax rates is downwards) and would not be in line with the objective of promoting economic growth. The headline corporate tax rate is already relatively high compared to our main trading partners and other middle income countries. The CIT tax burden of 4.6% of GDP is one of the highest in the world and would place SA second amongst OECD countries, behind only New Zealand (4.7% of GDP).

It is therefore expected that the additional tax revenues required will not be derived from this source.

CGT

In 2016, the effective capital gains tax rate for companies was increased from 18.6% to 22.4% (or 80% of the income tax rate). It is unlikely that this rate can be increased any further (this would effectively result in the taxation of gains arising from inflation) and we therefore don't expect any changes in this regard, notwithstanding that the Davis Tax Committee suggested this as an option to raise some funds for free higher education.

Tax base

Government has indicated that it is reviewing corporate tax incentives for their effectiveness with a view to removal where the costs outweigh the benefits. It is therefore possible that an announcement on the removal of certain tax incentives could be made in order to broaden the tax base and raise additional revenues. The incentive possibly most at risk is the reduced rates of tax for small business corporations, which costs the fiscus around R2.5 billion.

Further reforms aimed at broadening the tax base are also expected. In this regard, it is expected that further limitations on the deduction of interest will be introduced through a reduction in the cap and the broadening of the scope of the provisions.

Dividends tax

The dividends tax rate was increased from 15% to 20% in the 2017 Budget in combination with the increase in the maximum PIT tax rate to 45%. We don't expect further changes to this rate in the 2018 Budget.

Individuals

Personal income tax

Tax rates

In the 2017 Budget, the maximum tax rate was increased to 45% for incomes over R1.5 million while minimal relief was given for fiscal drag across all tax brackets and rebates. This was expected to result in additional revenues of R16.5 billion from PIT.

The PIT tax burden is now back at levels last seen in 1999/2000, at 10% of GDP. On top of this, a greater portion of the tax burden has been shifted to higher-income earners; in 2002/3, 78.3% of PIT was paid by 31.8% of the taxpayers while in 2015/16, 79% of PIT was paid by just 25.7%. These changes have resulted in the PIT tax base being placed under significant strain in recent years. Importantly, the PIT tax burden is significantly above the average for OECD countries (8.4% of GDP) and far above the average for developing countries. National Treasury is aware of the strain being placed on this tax base, the concerns that it raises for economic growth and investment, and growing slippage in compliance levels.

In light of the above factors and the significant increases in PIT in recent years, we do not expect a relatively large portion of the additional tax revenues to be raised to come from PIT and we don't foresee any changes in the tax rates for 2018/19. However, we expect that less than full relief will be given for inflation, and fiscal drag will be used to raise additional taxes of R5 billion to R8 billion. The bulk of this burden is expected to be borne by middle- and high-income earners as lower-income earners are relieved from PIT increases to compensate for an expected increase in the VAT rate.

Medical tax credits

There has been much speculation as to what will happen with medical tax credits given the suggestion that tax expenditure associated with them should rather be directed towards funding the NHI. The cost to the fiscus of the medical tax credits amounts to approximately R22 billion annually.

It has recently been suggested that the medical tax credits should be removed to provide the initial funding for the NHI fund. In the 2017 Budget it was stated that consideration was being given to possible reductions in this subsidy in future. In the MTBPS it was stated that 'The National Treasury is considering changes to the design, targeting and value of the medical tax credit as part of the policy development process for the 2018 Budget.' However, it was noted (correctly) that the subsidy is well targeted to lower- and middle-income taxpayers who receive both the bulk of the subsidy and the greatest value relative to incomes. In light of this, we don't expect that the subsidy will be reduced at this stage. It is possible, however, that no further increases in the tax credits for medical scheme contributions will be granted, allowing the value of the subsidy to be eroded by inflation over time. Such a policy would result in additional tax revenues of approximately R1 billion in 2018/19.

CGT

In 2016 the maximum effective capital gains tax rate for individuals was increased from 13.7% to 16.4%, or 40% of the income tax rate. No further changes were made to the inclusion rate in 2017, although the introduction of the new 45% band had the effect of increasing the maximum effective tax rate to 18%. It is possible that, given that capital gains tax is perceived to be a tax on the wealthy and the pressure to tax wealth, the inclusion rate could be increased to 50% and the maximum effective rate to 22.5%. Such an increase would raise in the region of R2 billion.

Trusts

The Davis Tax Committee recommended that discretionary trusts be subject to tax on all income and not a beneficiary in whose favour a discretion is exercised to vest income or capital gains. Such a measure would effectively negate the ability of a trust to split its taxable income between multiple taxpayers in order to reduce the tax liability. It is expected that this recommendation will be implemented in the 2018 Budget.

Estate duty and donations tax

The Davis Tax Committee recommended in its report that the inter-spouse exemption be withdrawn, that the primary abatement be increased to R15 million irrespective of the taxpayer's marital status and that the estate duty rate be increased to 25% where the dutiable value of an estate exceeds R30 million. In the 2017 Budget it was indicated that these recommendations would be considered in the 2018 Budget. We expect that these recommendations will be introduced for the most part.

Indirect taxes

VAT

VAT rate

There is arguably scope to increase the VAT rate (given the relatively low rate by international standards and the growing trend towards indirect taxes as a source of tax revenue globally). This has, most recently, been recognised by National Treasury in the 2017 Budget. Moreover, a 1% increase in the VAT rate could raise as much as R22 billion in additional revenue. Given the significant amount of additional revenue that is being sought for 2018/19, VAT is an attractive source of revenue as it is the only tax instrument that can raise large amounts of revenue with relatively small increases in rates due to its broad base and economic efficiency.

Historically, government has been reluctant to increase the VAT rate due to its perceived regressive nature and political resistance to increases. However, given the large tax shortfalls, the need to raise significant revenues and the pressure that the PIT tax base is under, we are of the view that government will have no choice but to increase the VAT rate by 1% to 15%. If this is to be done, a portion of the revenues raised from such an increase would need to be directed towards alleviating the burden of such an increase on the poor through increased social spending. Such spending could be in the form of an increase in social grants, but could also be justified by the introduction of free higher education for the poor. We are of the view that up to R5 billion would have to be directed at increased social spending, resulting in a net impact of approximately R17 billion.

Luxury VAT rate

We note the suggestion from some quarters that instead of raising the standard VAT rate, a higher rate be introduced for luxury goods. The Davis Tax Committee warned, though, that multiple VAT rates will add significantly to the complexity of the VAT system and the administrative burden while raising relatively small amounts of additional tax revenues. What is more important in the current environment is that it would not be possible to introduce multiple tax rates at short notice, as this would require significant system changes for both taxpayers and SARS. We therefore do not expect to see an introduction of higher tax rates for luxury goods.

Zero rating of fuel

In the 2017 Budget, it was proposed that the zero-rating on fuel be removed and that this would be subject to consultation ahead of the 2018 Budget. It was suggested that, to mitigate the effect on transport costs, government would consider combining this with either a freeze of or a decrease in the general fuel levy. The removal of the zero-rating on fuel would raise about R20 billion in additional VAT. However, no consultations have taken place as yet and it is therefore expected that fuel will continue to be zero-rated for the time being.

Fuel levies

The general fuel levy was increased by 30c/l or similar amounts in each of 2017, 2016 and 2015 as a means of raising additional tax revenues. The general fuel levy is slightly progressive and seemingly less politically sensitive than VAT, notwithstanding that, like VAT, it is a tax on consumption. As such, in recent times it has been seen as a viable option for government to raise additional revenues. We again expect the fuel levy to be increased. However, the extent of the increase will depend on whether the VAT rate is increased. If the VAT rate is increased, as we expect, we would expect the general fuel levy to be increased by approximately 30c/l once again. This would raise additional tax revenues of approximately R3 billion in real terms.

The RAF levy was increased by 50c/l in 2015, an increase of nearly 50%. No increase was provided for in 2016 and an increase of 9c/l was given in 2017, broadly in line with inflation. We expect an inflationary increase in the RAF levy once again in 2018 of 8c or 9c/l.

Transfer duties

In 2015 a new maximum rate of 13% was introduced for properties above R10 million. In 2017 the tax-free threshold was increased from R750 000 to R900 000. Further changes in 2018 are considered unlikely.

Securities transfer taxes

Securities transfer tax is currently levied at a rate of 0.25% on the transfer of shares. One possibility available to government to obtain additional tax revenues would be to increase the securities transfer tax rate. Doubling this rate would raise additional tax revenues of approximately R5.5 billion. Such a tax increase is likely to be perceived as progressive as it is a form of tax on wealth. However, the distortionary implications of any such increase on stock markets would require careful consideration. We expect to see this used as a last resort.

Sugar tax

The health promotion levy on sugary drinks is now due to be introduced from 1 April 2018 at a rate of 2.1c per gram of sugar that exceeds 4 grams per 100ml. It is not clear how much revenue will be raised by this tax, but we expect it to raise in the region of R1 billion.

Excise duties

Excise duties on tobacco and alcohol are a perennial soft target for increased taxes.

The targeted excise tax burdens for wine, beer and spirits are 11%, 23% and 36% of the weighted average retail price, respectively. It is expected that these tax burdens will be maintained or slightly exceeded for beer and spirits in 2018. As inflation for alcoholic beverages slightly exceeds CPI, it can be expected that increases in excise taxes on alcohol will slightly exceed CPI and contribute to real increases in revenue. However, the contribution to revenue increases from these taxes is expected to be minimal.

The targeted excise tax burden as a percentage of the retail selling price within each tobacco product category is currently 40%. As the rate of inflation on tobacco products is largely in line with CPI, it is not expected that real increases in tobacco taxes will result in any significant contribution to tax revenue increases.

It is possible that government may seek to increase the targeted tax burdens to raise additional revenues, although concerns about an increase in illicit trade will have to be considered, particularly on tobacco products.

Carbon tax

A revised draft Carbon Tax Bill was issued for comment in December 2017. The accompanying media statement indicated that the date of implementation would be announced during 2018 or in the 2019 Budget, taking into account the state of the economy. Accordingly, no further developments are expected in the 2018 Budget.

Other environmental taxes

The plastic bag levy, incandescent light bulb levy and vehicle emissions tax were increased in 2016 and no further tax increases are expected in the 2018 Budget. The tyre levy was introduced with effect from 1 February 2017 and is also not expected to be increased this year.

The electricity levy is also not expected to be increased due to the already high cost of electricity and the pending introduction of the carbon tax.

The 2017 Budget indicated that a discussion paper outlining the options to address acid mine drainage would be published for public comment and further consultation. This has not yet happened and it is therefore expected that no further developments will be announced in this regard.

Summary of possible tax increases

	R million
PIT fiscal drag	8 000
Medical tax credits fiscal drag	1 000
Individual CGT inclusion rates increased	2 000
VAT	22 000
General fuel levy	3 000
Sugar tax	1 000
Total	37 000

Our economic predictions

Budget deficit

The 2017 MTBPS planned for a fiscal deficit of R203bn (4.3% of GDP) during the 2018/19 financial year. However, official data shows that during the first eight months of the 2018/19 period, the deficit had reached R195 bn. The MTBPS did not propose any plans to remedy the fiscal situation - on the contrary, where fiscal deficits were always planned to narrow over the medium term, the MTBPS abandoned this promise. The nature of fiscal revenues and expenditure in the 2018/19 fiscal year so far indicates that the fiscal deficit will likely expand to at least R250 bn unless prudent spending cuts are implemented.

Portfolio flows

South Africa's currency has had its best three-month run in almost 10 years as it rides a wave of optimism following Deputy President Cyril Ramaphosa's election as the leader of the ruling African National Congress (ANC). The 19 percent gain in the period ended 31 January is more than double that of the next-best emerging-market currency, Poland's zloty.[1] Foreigners have also come roaring back into the stock market following the advent of the ANC's National Conference in December 2017. Bloomberg reports that "average daily flows into Johannesburg-traded shares are running at the highest rate since at least 1997".[2]

#Feesmustfall

The Government's plan to implement free higher education (for poor and working class students) will commence this year and be phased in over the next five years. The plan is well on its way to being implemented, despite the Government not having sufficient funding. Currently, the Government is facing a R50 bn revenue shortfall. State funding of higher education increased from R11 bn in 1994 to R26 bn in 2013, respectively.

It has been reported that the free higher education plan could cost R12.4 bn for 2018 alone. A reasonable funding plan is necessary to implement this announcement. In order to fund the free higher education plan, National Treasury will either have to cut expenses and/or increase government revenue substantially.

Nuclear discussion

In relation to nuclear power, Deputy President Cyril Ramaphosa indicated his opposition thereto at the 2018 World Economic Forum in Davos. This is in line with the 2017 MTBPS where the Finance Minister stated that South Africa will not be able to afford nuclear energy because the economy is growing too slowly. According, we do not expect any funding to be allocated to such infrastructure plans in this year's Budget Review.

1 https://www.bloomberg.com/news/articles/2018-02-01/south-africa-s-rand-last-looked-this-good-a-decade-ago-chart
2 https://www.moneyweb.co.za/moneyweb-opinion/columnists/six-reasons-south-africas-future-is-suddenly-a-lot-brighter/

National health insurance (NHI)

The NHI policy document released in June 2017 talks about proposals to end medical aid tax credits and redirecting it to fund NHI. This is expected to raise about R22 bn annually. Based on the economic forecasts and cost projects considered, it is estimated that NHI would cost R256 bn by 2025 with an anticipated shortfall of R108 bn in 2010 terms.

State Owned Enterprises

State-owned enterprises (SoEs) have a crucial role in maintaining the basic infrastructure of South Africa. Some of the main sectors where SoEs are dominant include electricity (Eskom), transport (Transnet, South African Airport Company (SAA) and South African National Roads Agency Limited (SANRAL)), telecommunications (Telkom and the SABC) and water (Rand Water). In the 2015/16 financial year, the overall financial position of the SoEs improved, compared to the previous year. This was mainly due to capital investment and positive earnings.[3] Currently, numerous SoEs are facing financial difficulties which led to the rating downgrades and in turn increased financial deficits. The Budget Review is expected to shed some more light on the Government's efforts to shore up the finances of SOEs and address future funding plans.

3 http://www.treasury.gov.za/documents/national%20budget/2017/review/Chapter%208.pdf

Contact

Kyle Mandy
Tax Policy Leader
PwC

+27 11 797 4977
kyle.mandy@pwc.com

Lullu Krugel
Economist
PwC

+27 11 797 4929
lullu.krugel@pwc.com

www.pwc.co.za/budget

(17-21445)