2021 Budget predictions

Time to take our medicine

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Economic and fiscal policy

GDP growth

PwC wish

Although real GDP is likely to return to pre-COVID-19 levels in three to four years' time, the recovery in employment to pre-COVID levels is likely to be delayed for up to nine years. This is due to anticipated annual increases in new entrants into the labour market.

In this context, the resuscitation of investment spending by South African companies is critical. It is therefore vital that Budget 2021 should boost the confidence of South African companies. This may be achieved in a number of ways. In this regard:

1. *Operation Vulindlela, launched in 2020, is aimed at boosting South Africa's economic competitiveness by monitoring and ensuring the implementation of key structural reforms. Budget 2021 should provide a much-needed update on progress in this regard.*
2. *Under the Economic Reconstruction and Recovery Plan (tabled by the President in October 2020), it was announced that, in order to intensify the participation of SMMEs in value chains within the economy, low-interest working capital loans (i.e. at 0% to 2%) would be made available to start-ups. Budget 2021 should provide details as to how this initiative will be funded and exactly who will benefit therefrom. In addition, further details should be provided as to the terms of such loans.*
3. *Under the Presidential Employment Stimulus Programme (announced in April 2020) R12.6 billion was allocated for the 2020/21 fiscal year in order to stimulate the creation and protection of employment. The Programme aimed to create or support up to 800 000 jobs during the 2020/21 fiscal year through an expansion of public and social employment, the protection of existing jobs in vulnerable sectors, and the support of livelihood and enterprise opportunities. The Programme is a key test of the ability of Government to manage a recovery in employment. In December 2020, it was announced that the Programme had supported 400 000 jobs. Budget 2021 should provide a report as to progress with this Programme and, specifically, whether the target of the creation or support of 800 000 jobs will be met by the end of the 2020/21 fiscal year (i.e. by March 2021).*
4. *In 2020, Government established a State Investment Fund as a vehicle to attract private sector investment in public infrastructure. There is a lack of publicly available information on the relevant instruments that are available for investment and the value of commitments received to date. Budget 2021 should provide details in this regard, as well as report on progress in securing such investment.*
5. *As part of the Reconstruction and Recovery Plan, Government committed to promoting economic recovery that is sustainable, job-intensive and inclusive. For example, one of the mechanisms announced as part of this commitment was the allocation of 40% of public procurement spending to businesses owned by women. Budget 2021 should report on progress in this regard.*

PwC prediction

There have been some positive economic developments since the MTBPS in October, and it is almost certain that the Budget will comment on these developments. The focus of the Budget is, however, likely to be on future developments.

In the MTBPS, National Treasury forecast a contraction in GDP of -7.8%. Following better than expected GDP data for the third quarter of 2020, National Treasury's GDP forecast for 2020 will be revised to be slightly more optimistic compared to the forecast in the MTBPS (i.e. the forecast contraction will be lower).

National Treasury's 2021 GDP forecast is, however, not expected to change significantly. This is due to the return of load shedding and the prospects of further lockdowns to combat a third wave of COVID-19 infections in 2021.

We therefore anticipate that National Treasury will forecast the following GDP contraction (2020) and growth (2021) numbers:

- 2020: -7.3% (revised from -7.8% forecast in MTBPS); and
- 2021: 3.2% (revised from 3.3% forecast in MTBPS 2020).

PwC estimates a contraction in GDP of 8.8% in 2020, and forecasts growth of 3.8% in 2021.

Fiscal balance

PwC wish

As has been the case for a number of years, the single biggest challenge to desperately needed fiscal consolidation is the size of the growing public sector wage bill. Although past Budgets have articulated that a firm stance would be taken on addressing this issue, the matter is now in the hands of the judiciary insofar as the last year of the public sector wage agreement is concerned, which was held by Labour Appeal Court to be invalid and which is being appealed to the Constitutional Court.

In any event, Budget 2021 must – of necessity – once again make a firm commitment to reduce the public sector wage bill. This would confirm that the Minister of Finance still enjoys the political support to effectively address this and other issues, without which he will be hamstrung in his ability to implement fiscal consolidation in the medium term.

PwC prediction

MTBPS 2020 projected that 2020/21 would see a fiscal deficit equal to 15.7% of GDP – up from 6.4% in 2019/20 and the largest on record – due to the adverse effect of the recession on government revenue. However, based on better-than-expected tax collections to the end of December 2020, slightly stronger economic growth assumptions, and assuming no significant change in expenditure, this deficit could be revised lower towards 15.0% of GDP.

MTBPS 2020 projected that the 2021/22 deficit would narrow to 10.1% of GDP. Given higher than expected revenues for 2020/21, it is likely that this projection will be narrowed further by National Treasury to below 10% of GDP. Further narrowing of the deficit will depend on the successful implementation of structural reforms and measures to support the economy, as well as a firm stance being taken on the public sector wage bill.

Expenditure

PwC wish

MTBPS 2020 signalled that the government will, from 2022, implement the principles of zero-based budgeting (ZBB) over the medium term. ZBB is a budgeting method where all expenditures must be justified for each new financial period. With ZBB, instead of rolling over budgets from the previous year, the budgeting process starts from a "zero base" for all spending activity.

ZBB would be instrumental in addressing the negative impact of unsustainable incremental increases to expenditure, particularly wasteful expenditure. Although it is probably too soon to expect significant progress in the implementation of ZBB, Budget 2021 should give a clear indication as to plans to accelerate the implementation of ZBB from 2021, particularly in the context of a fiscal deficit that is at historic highs with public debt being pushed to unsustainable levels.

PwC prediction

Budget expenditure will be trimmed at the margins and reprioritized towards medical and other appropriate and necessary social expenditure. The Minister of Finance is likely to restate the commitment of Government to reducing the public sector wage bill.

Despite pressures on Government to source funding for a COVID-19 vaccination programme, it is unlikely that any expenditure already promised for SOEs will be reallocated for this purpose.

Debt

PwC wish

MTBPS 2020 indicated that, by 2023, contingent liabilities are expected to exceed R1 trillion. This is the result of the need for the government to guarantee financing for SOEs who are struggling to access finance in capital markets. The long-standing wish is for the Minister of Finance to drastically reduce the provision of debt funding guarantees to SOEs. This may be achieved by facilitating an increase in private sector investment and the provision of management expertise.

On the basis that the debt trajectory is upwards over both the medium and long term, Budget 2021 should emphasise the urgent need for fiscal consolidation and, to this end, detail concrete measures to slow any further increases in public debt.

PwC prediction

The Minister of Finance will likely once again emphasize the need to ensure an active approach to debt management, and that a passive approach will be damaging to South Africa's long-term fiscal sustainability.

SOEs

PwC wish

A comprehensive cost-benefit analysis of the contribution of SOEs to South Africa's society and economy is urgently required. With a view to improving this contribution, Budget 2021 should announce that appropriate assessments will be conducted in this regard. This will enable a determination of which long-term plans and funding mechanisms benefit South Africans the most.

PwC prediction

Budget 2021 is unlikely to depart from previous financial commitments made to Eskom, SAA and other SOEs. Although such funds may be better spent on healthcare and other social needs, it is likely that political pressures will prevent National Treasury from reducing the quantum of expenditure allocated to the bailout of SOEs.

Credit ratings

PwC prediction

Given the high and rising levels of Government debt (which are, as a result of both spending and revenue pressures, unlikely to change in the short term), it is possible that ratings agencies are not satisfied by Budget 2021.

Taxes

2020/21 tax revenues

PwC prediction

The COVID-19 pandemic has had a devastating impact on tax revenues for the 2020/21 fiscal year. However, there has been significant improvement in revenue collections, particularly in the final three months of the 2020 calendar year.

After forecasting total tax revenues of R1.425 trillion in Budget 2020, National Treasury made a significant downward revision to this figure in the Supplementary Budget Review (SBR) tabled in June. The revised forecast (of R1.121 trillion) was R304 billion lower than the Budget 2020 forecast. This forecast was revised downwards by a further R8.7 billion to R1.113 trillion in MTBPS 2020.

Despite these significant downward revisions to forecasts in June and October 2020, revenue collections between October and December were surprisingly resilient across all tax types.

Significantly, corporate income tax (CIT) collections in December 2020 saw a year-on-year increase of approximately 15% over December 2019. This increase appears to have been primarily driven by companies in the mining sector.

In the case of personal income tax (PIT) collections, although collections for October and November 2020 were lower than the corresponding months in 2020 by 8% and 4% respectively, December 2020 collections saw a year-on-year increase of 1.3% over PIT collections for December 2019.

Regarding VAT, collections for October and November 2020 also saw year-on-year increases of 17% and 20% over October and November 2019 respectively, with December 2020 showing a marginal year-on-year increase over December 2019, but still significantly above the forecast decline for the fiscal year of 17%. VAT collections were likely supported by expanded social grants and UIF payments, which lent some support to consumers. Consequently, it is likely that VAT collections will slow further as these social payments come to an end. This is already evident in the slowdown in VAT revenue for December 2020.

There is some difficulty in forecasting tax revenues for the remainder of the 2020/21 fiscal year, largely because of the distortionary effect on tax revenues of the COVID-19 pandemic itself (including lockdown and other measures adopted to limit the spread of the virus), but also because of tax relief measures which had the effect of deferring tax payments (including provisional tax and excise duties).

In addition, there are a number of downside risks to revenue collections for the remaining three months of the fiscal year. These downside risks include the effects of the adjusted Level 3 lockdown implemented with effect from 29 December. This lockdown, coupled with the cessation of social relief measures, has undoubtedly affected the hospitality and entertainment industry, as well as VAT and excise collections.

Despite the above difficulties and downside risks, based on the resilience of revenues and higher than expected collections to December 2020 and the overall trend in revenue collections for the year, we anticipate total revenue collections for fiscal year 2020/21 to be better than the forecast of MTBPS 2020 by between R100 billion and R108 billion.

2021/22 tax revenues

PwC wish

It is hoped that National Treasury will not, as was announced in the SBR and MTBPS 2020, implement measures to increase taxes in the 2021/22 fiscal year. Given the significant improvement in revenue collections in the quarter ending 31 December 2020, as well as an improved revenue outlook for the remainder of 2020/21, as well as for 2021/22, National Treasury has sufficient flexibility to not implement these increases and rather adopt a position that is more supportive of economic growth. This is critical in the context of an economy recovering from the effects of the COVID-19 pandemic, as well as large tax increases over the previous five years.

PwC prediction

In the SBR, National Treasury announced that, given the extent of fiscal consolidation required (which was, to a large degree, caused by the significant fall in revenues that was forecast for 2020/21 at that stage), both expenditure reductions and tax increases would be necessary to stabilise government debt. To this end, the SBR announced tax increases of R5 billion in 2021/22, R10 billion in each of 2022/23 and 2023/24, and R15 billion in 2024/25. MTBPS 2020 repeated that these increases would be necessary to improve revenue collection over the next four years.

However, tax revenues for 2020/21 are likely to significantly exceed the forecasts made in MTBPS 2020 by between R100 billion and R108 billion. This affords a degree of flexibility to National Treasury, and should have the effect of reducing pressure to raise taxes. In light of this, it is expected that the tax increases for 2021/22 proposed in MTBPS 2020 will no longer be introduced while those for the outer years may be relaxed, either in terms of a complete elimination or reduction in quantum. Assuming that National Treasury does not implement the tax increases announced in the SBR, based on:

- our forecast of real GDP growth for 2021/22 of 3.8%;
- an inflation forecast of 4.4% for 2021/22;
- anticipated total tax revenues for 2020/21 of R1.213 trillion; and
- a relatively conservative tax buoyancy of 1.2,

we estimate that total tax revenues for the 2021/22 fiscal year will approximate R1.3312 trillion. This estimate exceeds the forecast of R1.2795 trillion in MTBPS 2020 by approximately R52 billion, which affords National Treasury a degree of flexibility in limiting tax increases over the medium term.

Funding of COVID-19 vaccine

PwC wish

Budget 2021 should provide full details as to the total costs of implementing a comprehensive vaccination programme in South Africa.

Given the significantly improved revenue outlook for 2020/21 and 2021/22, we do not believe that it will be necessary to increase taxes in order to fund a vaccination programme. Furthermore, discussions are under way with medical schemes for the funding by them of non-members. This would, in effect, amount to a tax on the medical schemes and be borne indirectly by medical scheme members.

PwC prediction

There has been a great deal of speculation recently relating to how a COVID-19 vaccine will be funded. Government has stated that all sources of finance are being considered (including tax revenues, additional debt and contributions from the private sector, including medical schemes).

It should be noted that MTBPS 2020 made no specific provision for the funding of a vaccine. There is still a lack of clarity in this regard, and there is uncertainty as to where the funds needed for the rollout of a vaccine will be sourced from.

Many commentators have argued that National Treasury will need to increase taxes in order to raise funds for the rollout of a vaccine. We do not believe that this is necessary, given the significantly improved revenue outlook in the short to medium term. Much will, however, depend on the ultimate cost of the rollout of a vaccine (which would include not only the direct cost of the vaccines themselves, but also the costs of implementing a vaccination programme). To the extent that National Treasury does not secure funding from the private sector (whether from medical schemes or elsewhere) we expect that the cost of the vaccination programme will be funded from existing revenue sources or debt and by either a temporary increase in the expenditure ceiling, a reprioritization of expenditure or utilising the contingency reserve, or a combination of these.

Efficiency of the South African Revenue Service (SARS)

PwC wish

In MTBPS 2020, it was explicitly stated that the medium-term tax forecasts did not include any additional revenue from more effective revenue collection.

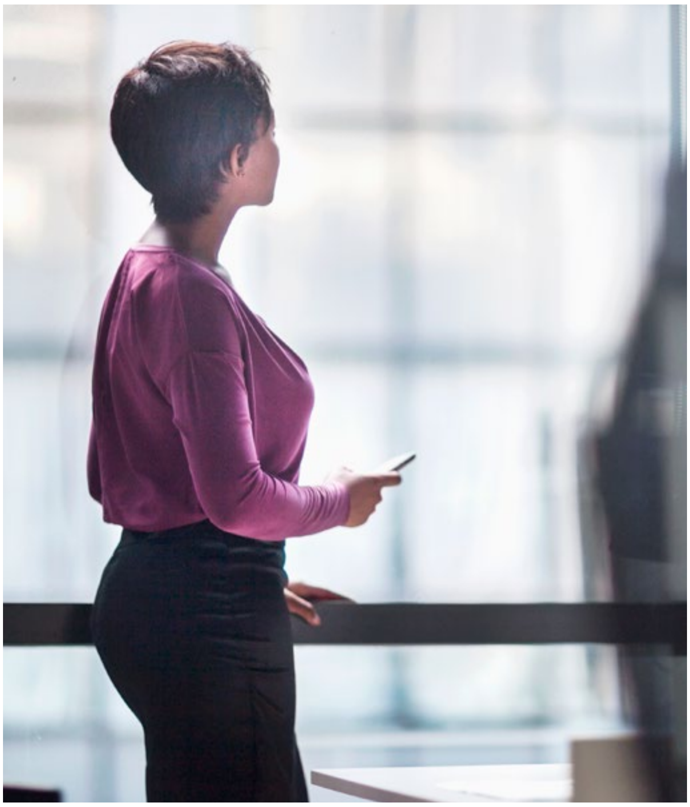
In our view, the tax gap in South Africa could be as high as R200 billion. In this context, there is a significant opportunity for SARS to improve its revenue collection performance over the short to medium term without increases in taxes.

In order to improve revenue collection, it is of critical importance that SARS be provided with adequate funding to invest in the necessary skills and technology.

Budget 2021 should make a strong statement and commit additional resources to SARS for this purpose, the return on investment being clear.

PwC prediction

We expect that National Treasury will allocate additional funding to SARS to recapacitate it with the necessary skills and invest in technology.



Corporate income tax

PwC wish

Although Budget 2020 announced that, over the medium term, the CIT rate would be reduced by a restructuring of the corporate income tax system on a revenue-neutral basis, it is unlikely that this will take place in 2021/22.

It is, however, hoped that further details will be provided as to the likely timeframe within which the CIT rate will be reduced, as well as the extent of the likely reduction.

PwC prediction

At this point, no changes are expected to the general corporate tax rate of 28%, nor to the inclusion rate for capital gains tax. However, should an announcement be made to increase personal income tax by way of a once-off surcharge in order to fund a COVID-19 vaccine (which we consider unlikely), it is possible that a temporary increase to the CIT rate could be implemented in order to limit arbitrage opportunities in the short term.

In Budget 2020, it was announced that Government would, over the medium term, restructure the corporate income tax base by broadening the base and reducing the corporate income tax rate. The purpose of doing so is to promote South Africa's economic growth.

Following the initiation of a number of proposals in the 2020 legislative cycle (including the introduction of revised interest deduction limitation rules, the limitation on the use of assessed losses and the review of certain incentives), it is anticipated that Budget 2021 will make further announcements in this regard.

We expect that Budget 2021 will propose that both the revised interest deduction limitation rules and the limitation on the use of assessed losses be introduced with effect from 2022.

In addition, it is anticipated that appropriate announcements will be made relating to the implementation of recommendations flowing from the OECD BEPS project, with particular reference to BEPS Pillar 2 and the taxation of the digital economy.

Dividends tax

PwC prediction

We do not anticipate any change to the dividends tax rate for 2021/22.

Personal income tax

PwC wish

Tax rates

In the 2020 Budget, and following a number of years of substantial tax increases in personal income tax (PIT), a little more than full fiscal drag relief was given with the aim of supporting a recovery in economic growth.

Given the dire state of the South African economy in the wake of the economic effects of the COVID-19 pandemic, it is hoped that full fiscal drag relief is once again given in Budget 2021.

PwC prediction

Tax rates

Despite the announcement in the MTBPS of tax increases in 2021/22 amounting to R5 billion (which would be easily funded by a below-inflation adjustment to the PIT brackets), the short and medium-term revenue outlook has improved substantially since then. We are therefore of the view that it is unlikely that National Treasury will seek to implement the tax increase of R5 billion previously announced for 2021/22, and that it is likely, in order to support economic recovery, that full fiscal drag relief adjustments to the PIT brackets will be given in Budget 2021.

Medical tax credit

The 2018, 2019 and 2020 Budgets provided for below-inflation increases in the medical tax credit. The stated aim of this approach was to assist Government in funding the rollout of National Health Insurance.

Given the fact that many medical aids have, for 2021, postponed premium increases or, alternatively, made below-inflation adjustments to premiums, it is likely that no adjustment will be made to the medical tax credit.

Estate duty and donations tax

PwC prediction

Any increases in estate duty and donations tax are unlikely to raise substantial additional revenue and, given the challenges faced by SARS in enforcing donations tax and in the administration of estate duty, could have an effect on SARS' overall effectiveness in administering other taxes.

No changes are therefore expected in this regard for 2021/22.

There is, however, a possibility of an announcement that the estate duty and donations tax will be reviewed in the medium term as part of a review of the taxation of wealth.

VAT

PwC prediction

VAT rate

We do not anticipate any changes to the VAT rate.

Luxury VAT rate

On the basis that (as the Davis Tax Committee has warned) multiple VAT rates add significantly to the complexity of the VAT system and therefore the administrative burden on both taxpayers and SARS, we do not expect the introduction of higher VAT rates for luxury goods.

Ad valorem duties

PwC prediction

Rates of *ad valorem* excise duties, which are applied to some goods that are consumed mainly by wealthier households, were raised in the 2018 Budget.

Given that the list of goods that are subject to *ad valorem* duties is fairly narrow, this list could be expanded to cover additional luxury goods. Goods currently subject to *ad valorem* duties include items such as perfumes, beauty products, fireworks, furs, air-conditioning, cellular phones, certain electronic equipment, motor vehicles and firearms.

An expansion of the list of goods that are subject to *ad valorem* duties is possible.

Fuel levies

PwC wish

Following the rejection of the Road Accident Benefit Scheme by Parliament in August 2020, MTBPS 2020 was silent on what measures would be taken to address the issue of the growing contingent liability of the RAF.

It is hoped that clear and detailed plans, beyond a further above-inflation increase in the levy, as to how Government proposes to deal with this situation will be announced in Budget 2021.

PwC prediction

General fuel levy

Following a number of years of above-inflation adjustments to the general fuel levy, an inflationary adjustment was made to the levy in Budget 2020. The general fuel levy is only slightly progressive and was previously seen as being less politically sensitive than VAT. This perception did, however, change with the increased attention resulting from the VAT increase in 2018.

Any increase in the general fuel levy is therefore likely to only be inflationary. We therefore expect the general fuel levy to be increased by approximately 15c/l.

RAF levy

In the MTBPS, it was stated that the RAF is Government's largest contingent liability, and that its accumulated deficit is projected to grow substantially to R593 billion by 2022/23. This is a result of claims against the fund growing significantly faster than increases in the RAF levy, with the effect that there has been insufficient growth in the levy to offset growth in liabilities.

The Road Accident Benefit Scheme, which Government developed to replace the existing scheme, was rejected by Parliament in August 2020, and this liability will therefore continue to grow.

In the absence of any other measures to deal with this issue, Budget 2021 could provide for an above inflation increase in the RAF levy of approximately 30c/l in order to limit the growth in the deficit.

Transfer duties

PwC prediction

Given the state of the economy and the residential property market (in which property prices are under severe pressure), no adjustments to transfer duties are anticipated.

Health Promotion Levy

PwC prediction

The Health Promotion Levy (HPL), also known as the sugar tax, is an excise tax that is levied on sugar-sweetened beverages.

It is anticipated that Budget 2021 will provide for an inflationary increase in the levy.

Excise duties

PwC prediction

Excise duties on tobacco and alcohol have traditionally been a soft target for increases in taxes. There has also been a great deal of debate regarding the adverse effects of the abuse of alcohol on society, and a number of commentators have made calls for substantial increases in excise duties on alcohol in order to limit abuse by increasing its cost to the consumer.

However, in the current environment, an increase in excise taxes (on alcohol and taxes) is not likely in Budget 2021, given the uncertainties and difficulties faced by the tobacco and alcohol industries following the lengthy sales bans during 2020 and early 2021. In addition, National Treasury is all too aware of the fact that black market networks have developed as a result of these bans, and increases in excise duties are likely to exacerbate this problem (particularly in the case of tobacco). In addition, possible further bans on alcohol or tobacco sales during 2021 would have an adverse effect on (and interrupt) revenues from these sources. We are therefore of the view that tax increases will be limited to inflation at this stage, although above inflation increases could be considered as part of a package of measures in the future.

Environmental taxes

PwC prediction

In Budget 2020, Government announced that an environmental fiscal reform review paper would be published. It was stated that this paper would explore the potential for new environmental taxes and reforms to existing instruments, such as, for example:

- restructuring the general fuel levy to include a local air pollution emissions component;
- alleviating traffic congestion through road pricing charges and design options for an annual carbon dioxide tax on vehicles, in collaboration with the Department of Transport and provincial governments;
- reviewing inefficient fossil fuel subsidies, including the VAT zero-rating of transport fuels;
- considering product taxes on electrical and electronic waste; and
- reviewing the tax treatment of company cars to incentivise the use of more fuel-efficient vehicles.

No such paper was published by National Treasury during 2020, and it is anticipated that an announcement will be made in this regard in Budget 2021.

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