PwC budget highlights 2019

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Major tax announcements

Personal Income Tax

Given the economic realities facing the Minister of Finance this year, it is unsurprising that he had a difficult task balancing the need to improve tax revenue with the implications of placing additional tax burdens on the individual taxpayer. As a result, the Minister today announced that there would be no increases to individual tax rates for 2019/2020, although there would be the usual increases in sin taxes and fuel taxes.

In contrast to what we have become accustomed over the past number of years, there will also be no adjustment to the individual tax tables to take the effects of inflation into account. In other words, there will be no adjustment to take into account the effects of bracket creep. The net result of this is that Treasury expects to collect an additional R12.8 billion. There will, however, be a very small increase in the primary, secondary and tertiary rebates of 1.1% which will offer very limited relief (R153, R234 and R261 per year, respectively).

There were also a number of matters raised in the Budget Review in terms of addressing some practical difficulties for employers. For example once the foreign earnings exemption changes come into effect on 1 March 2020 as well as the need for foreign employers to register as such with the South African Revenue Service (SARS). There will also be a slight change to the income bands that apply to the Employment Tax Incentive to take into account the National Minimum Wage Act and inflation.

Unlike in previous years, there has been no adjustment to the travel allowance tables this year, although there has been a small increase to the deemed subsistence allowance amounts which employers can pay to employees who travel overnight on employer business. In prior years Treasury raised the prospect of doing away with the medical tax credit available to taxpayers who are members of medical aid schemes, but this year there has been no change to this credit. Unlike in previous years, there has also been no increase in this credit to take inflation into account.

Barry Knoetze
Associate Director PwC Tax

Revenue collections

As expected revenue collections have been revised downwards for the current year in line with our projections. The revenue forecast for next year uses a tax buoyancy ratio of 1.15 before the R15 billion of tax increases. We are concerned that this is unrealistic in the current environment. A buoyancy of that quantum has not come close to being achieved in recent years. As such we expect that the revenue forecast for next year is unlikely to be achieved with the result that the deficit would likely be higher than the 4.5% forecast.

Kyle Mandy
PwC Tax Policy Leader

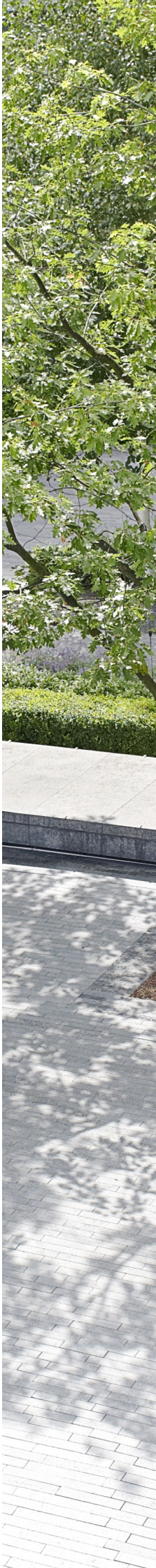
Insurance Industry

The Insurance industry has seen a number of substantial changes to tax legislation over the past number of years. The most significant of these were the changes brought about by the implementation of Solvency Assessment Management (“SAM”) and the promulgation of the new Insurance Act No. 18 of 2017 ("the 2017 Insurance Act").

The new legislation brought about a number of anomalies and also situations that required additional clarification. Most of these amendments and clarifications were enacted between 2015 to 2018. It appears as if the last of the refinements to the new legislation would comprise the tidying of references to the old legislation governing insurers, i.e. the Long-Term Insurance Act (1998) and the Short-Term Insurance Act (1998) to that of the 2017 Insurance Act.

In addition, it is also proposed that legislation be introduced to address the transfer of assets that is required between the Risk Policy Fund (introduced in recent years) and the Untaxed Policyholder Fund to curb the administrative burden created in this regard.

Alwina Brand
PwC Tax Partner



Environmental taxes

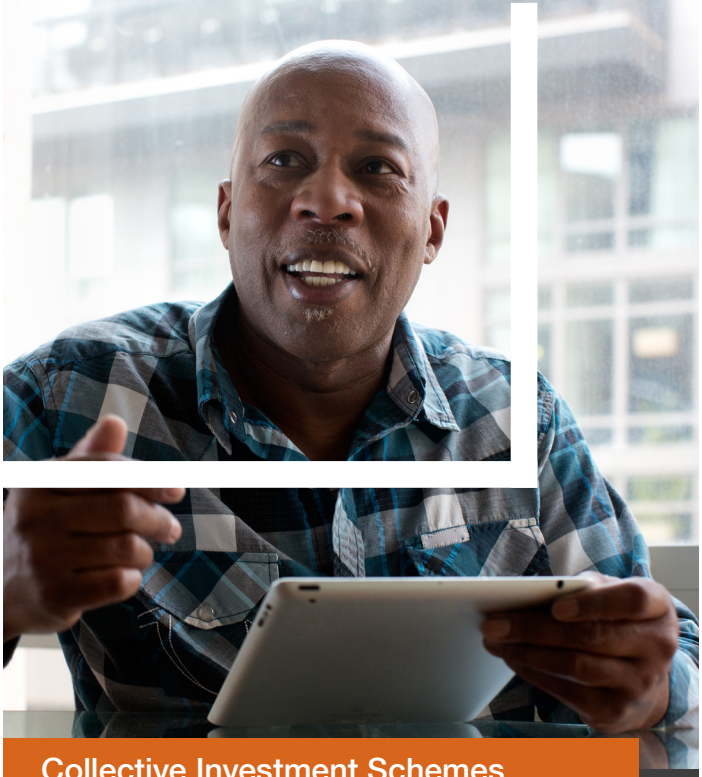
The environment and 'green warriors' received some good news in the Finance Minister's Budget Speech. The Minister announced that National Treasury will publish a draft Environmental Fiscal Reform Policy Paper in 2019. This Paper will outline options to reform existing environmental taxes to broaden their coverage and it will also consider the role new taxes can play in addressing air pollution and climate change. Currently, South Africa's most prominent environmental tax comprises of the Carbon Tax that will be introduced on 1 June 2019.

Presently, the participants in the South African economy are not materially incentivised to pursue environmentally sustainable initiatives, either through severe penalties or rebates. When having regard to the pressure that lobbyists are placing on governments globally, it is welcome news that National Treasury is considering the role of new taxes or incentives to address the promotion of efficient water use, the reduction of waste and the encouragement of improvements in waste management.

Equally in step with global trends and norms, the Government will investigate a tax on “single-use” plastics including straws, caps, beverage cups and lids, and containers to curb their use and encourage recycling.

The announcement that the biodiversity tax incentive will be reviewed will also be welcomed by those interested in sustainability and the environment.

Alwina Brand
PwC Tax Partner



Collective Investment Schemes

The Collective Investment Scheme industry provides access to listed instruments to the public at large through a participatory interest in the total Collective Investment Scheme portfolio, which would generally comprise listed shares, bonds and similar instruments. These investment vehicles serve to enhance the options that the general public has to save for the future.

Collective Investment Schemes faced difficulty in 2018 when amendments were proposed in the Taxation Laws Amendment Bill (2018) to tax the profits of certain Collective Investment Schemes as revenue instead of capital. Most investors utilise these vehicles for long-term investment purposes, therefore the potential of suffering taxes at full income tax rates as opposed to capital gains tax rates served to diminish the appeal of Collective Investment Schemes as a savings option. Public comment to the draft legislation emphasised the negative impact that such a change in tax policy would have on the Fund industry and the South African savings culture at large.

The Finance Minister announced that government stated it would require more time to collaborate with the Collective Investment Schemes industry to find solutions to the negative impacts of the proposed legislation. It has been proposed that this study be conducted during the 2019 legislative cycle.

The cooperation between government and the Fund industry would be welcome news for the investor public.

Alwina Brand
PwC Tax Partner

Corporate reorganisations

South African income tax legislation makes provision for a number of instances where corporate reorganisations may be effected in a tax neutral manner. This legislation is generally referred to as the group roll over relief rules.

These group roll over relief rules provide a mechanism whereby the transferee steps into the shoes of the transferor for tax purposes, thereby facilitating the tax free transfer of assets within groups of companies. The rules are clear with regard to the transfer of trading stock, capital assets and so-called allowance assets. However, the application of these roll over relief rules to assets that would realise foreign exchange gains or losses were subject to interpretation.

It has now been clarified that it is National Treasury's intention to exclude exchange differences arising from corporate restructure transactions from the roll over relief rules. National Treasury appears to be targeting 'exchange items' as defined in section 24I of the Income Tax Act, No. 58 of 1962 as well as interest bearing assets. This means that the unrealised foreign exchange gains or losses inherent to the underlying assets/liabilities on the date of transfer would be triggered in the transferor companies.

Alwina Brand
PwC Tax Partner

PwC commentary on indirect taxes

Commentary from Lesley O'Connell (Indirect Tax Partner), Charles de Wet (Head of Indirect Tax) and Herman Fourie (Customs, Excise and International Trade Specialist)

Review of the definition of "group of companies" for electronic services regulations

It is disappointing that the final Electronic Services Regulations have not as yet been published. The first draft of these Regulations was published a year ago with the release of the 2018 Budget. Non resident companies supplying electronic services into South Africa require certainty in order to make the required amendments to their ERP systems. Such system changes may take a minimum of 4-6 weeks resulting in involuntary non-compliance for non-resident suppliers.

The proposed amendment seeks to amend the "group of companies" definition to broaden the ambit of the exclusion.

No amendment is proposed to "telecommunication services" as referenced in the draft Regulations.

Aligning provisions of the VAT Act with the Insurance Act

Due to the promulgation of the Insurance Act in 2018, it is proposed that certain definitions referenced in the VAT Act will be revised to ensure alignment. In addition, it will be clarified that the transfer of a long-term reinsurance policy is an exempt financial service.

Refining the VAT corporate reorganisation rules

The VAT Act provides relief for companies in the same group by treating the supplier and the recipient of goods or services as the same person during corporate reorganisation transactions.

VAT treatment of rental stock paid in terms of the National Housing Programme - section 8(23) read with section 11(2)(s)

The VAT Act provides that a vendor (such as a municipality) is deemed to supply services to any public authority (for example, the Department of Human Settlements) if the vendor is paid or makes a payment in line with the National Housing Programme outlined in the Housing Act (1997). A result is that the municipality is regarded as making a zero rated supply to the public authority, despite the fact that the costs were incurred to build rental stock (which is an exempt supply). VAT in this instance is therefore not a cost to the municipality. This appears to be contrary to the normal principal of input tax. The proposal is unclear as to what is the intention of National Treasury, i.e. insert legislation that permits this deduction or require the municipality to effect an output tax adjustment, that is, to recoup input tax deducted on the construction of the rental stock.

Review of Commissioner's discretion

It is proposed that a constitutional review of section 72 be conducted. Section 72 provides the Commissioner with a discretion to alleviate the burden of complying with the normal provisions of the VAT Act in cases where "difficulties, anomalies or incongruities" arise due to the manner in which a particular vendor / class of vendors conduct(s) its business.

In recent years, the Commissioner has in very limited instances exercised his discretion, despite the requirements of the section being met. The original policy intent to provide the Commissioner with a discretion to assist vendors in certain limited instances should not be forgotten.

Customs and Excise

Excise duties on tobacco and alcohol products to increase between 7. 4 and 9 per cent from 1 April 2019.

General fuel levy increases by 15 cents per litre and road accident fund levy increases by 5 cents per litre on 3 April 2019.

A carbon fuel levy at 9 cents per litre on petrol and 10 cents per litre on diesel will be introduced with effect from 5 June 2019.

Carbon Tax

The carbon tax will be implemented on 1 June 2019.

Increase in health promotion levy

The levy rate will increase to 2.21 cents per gram in excess of 4 grams of sugar per 100ml from 1 April 2019.

SARS publication of the excise rewrite discussion document

SARS has compiled an excise rewrite discussion document that will be published for public comment as part of redrafting the excise duty legislative framework.

Additional proposed amendments

Reviewing the tax treatment of duty-free shops;

Excluding bulk wine movements from the compulsory tariff determination requirement;

Extending the fiscal marking, tracking and tracing intervention to include excise and levy goods; and

Progress with the review of the diesel refund administration: The design of the new standalone diesel refund administration will be outlined in draft rules and notes that will be developed and published for public comment during the course of the year.

Ad valorem proposals to consistently apply and extend current items

Expanding the computer category: It is proposed that the computer category be expanded to include any apparatus with a screen larger than 45 cm;

Expanding the gaming category: It is proposed that the provisions be amended to include any external screen or surface on which gaming console images can be reproduced; and

Government will review provisions relating to duty rebates and refunds in circumstances of vis major (an unpreventable incident caused by a superior external force) in the Customs and Excise Act and its schedules to align them with international best practice. Consideration must also be given to relief from the imposition of VAT due.

Ad valorem excise duty on motor vehicles

Because of the way ad valorem excise duty is calculated, vehicles produced locally are taxed at a higher rate than imported vehicles. To remove this anomaly, government proposes to align the tax treatment.

RAF levy diesel refunds

The farming, forestry and mining industries are refunded levies paid when they buy diesel. This refund is intended to offset the RAF levy these users pay. However, these diesel users still receive benefits from the RAF if they experience accidents involving motor vehicles, even if the accident is off- road. It is proposed that the RAF levy diesel refund benefit for these primary production industries be limited to ensure that diesel users in these sectors equitably contribute towards their RAF indemnity.

Economic commentary

Finance Minister Tito Mboweni delivered the Budget Speech 2019 to Parliament on February 20. The foreword to the 2019 Budget Review indicated that this year's budget "addresses immediate risks to the economy and the public finances" – a frank assessment of what most South Africans expected from his speech.

His address was forthright about the challenges facing the country, and while there were many bitter pills to swallow in the detail, the minister provided some good news (for rating agencies) on key subjects like Eskom and the public sector wage bill.

These sweet words, depending on whose ears it falls, can, however, not detract from the wide budget deficit and huge debt that the public sector is struggling with: PwC sees a high probability of Moody's Investor Service downgrading South Africa to non-investment grade this year.

By PwC Strategy& economists
Lullu Krugel & Christie Viljoen

Key points:

- This year's budget "addresses immediate risks to the economy and the public finances".
- National Treasury expects GDP growth to rise from 0.7% in 2018 to 1.5% in 2019 and 1.7% in 2020.
- Tax revenue projections for 2018/19 have been revised lower by R15.4 billion (1.2%) compared to MTBPS estimates.
- No changes to personal income tax brackets in 2019/20, allowing for bracket creep – this will move some South Africans into higher brackets after they receive their inflation adjusted increases.
- National and provincial salary budgets cut by R27 billion over the next three years by encouraging early retirement.
- Consolidated expenditure is planned at R1.83 trillion in 2019/20, equal to a hefty 33.7% of GDP, and 1% higher than forecasted in October.
- Debt service costs will remain the fastest growing spending item.
- The fiscal deficit for 2018/19, is expected to end up at 4.2% of GDP, 0.2 percentage points higher than the October forecast and the same as PwC's expectations prior to the budget.
- Planned fiscal deficit of 4.5% of GDP in 2019/20 shortfall will be wider than previously planned and the largest since 2012.
- Gross national debt projected to stabilise at 60.2% of GDP in 2023/24.
- R23 billion per annum for reconfiguration of Eskom under an independent Chief Reorganisation Officer (CRO).
- Rating agencies will be unhappy with the widening of the fiscal deficit, higher peak in public debt, and increased exposure to the financial woes at SOEs.

Improved economic growth outlook over the medium term

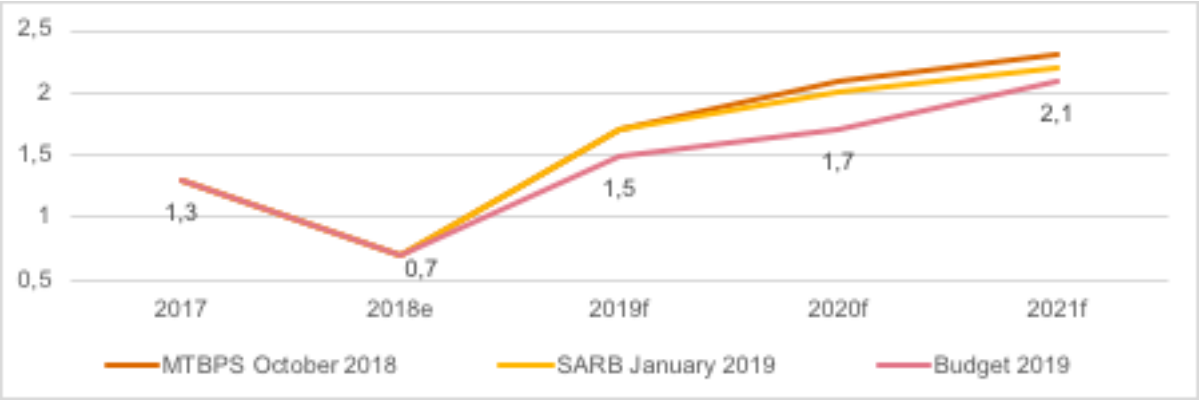
It is time for us to sow the seed of renewal and growth,
– Minister Tito Mboweni

The economic outlook has weakened since the tabling of the Medium-Term Budget Policy Statement (MTBPS) in October 2018. The National Treasury expects economic growth to rise from 0.7% last year to 1.5% in 2019 and 1.7% next year. These forecasts are marginally higher than the current forecasts from the International Monetary Fund (IMF) and the World Bank.

The downward revision of growth projections has been seen in most budgets over the past five years or so. Nonetheless, the state expects a decline in policy uncertainty, structural reforms and a more capable state to lift economic growth this year to the highest level in many years. This is an arduous task given a weaker outlook for the global economy.

The Minister is looking at a recovery in business and consumer confidence to stimulate the local economy. The reforming of State Owned Enterprises (SOEs) is also expected to be a contributing factor in supporting healthier economy. The Minister was correct in saying that, following a decade of economic weakness, there are some positive signs for South Africa. However, budget since budget speeches have been over-optimistic about the pace of economic growth, and hence, PwC expects economic growth of 1.4% in 2019.

Another downward revision in real GDP growth (%) estimates



Sources: National Treasury, South African Reserve Bank (SARB)

Growth-enhancing measures include a relaxing of international visitor visa regulations, expanded eligibility for the youth employment tax incentive scheme, nearly R20 billion in industrial business incentives, and President Cyril Ramaphosa's promised Infrastructure Fund. Disappointingly, there was little additional information forthcoming on this fund beyond what was already known.

Revenue boost from no change in personal income tax brackets

Gross tax revenue projections for 2018/19 have been revised lower by R15.4 billion (1.2%) compared to MTBPS estimates. Around half of this is due to higher-than-expected VAT refunds, with the remainder contributed to lower tax collections, driven to a large extent by disappointing tax collections from companies and personal income taxes.

In response to ongoing concerns over the underperformance of collections by the South African Revenue Service (SARS), Minister Mboweni indicated that the Davis Tax Committee would investigate the gap between revenue collected that taxes that should be paid.

Budget Speech 2019 acknowledged that several tax rates have increased in recent years to deal with revenue pressure. The Minister indicated that improvements to the revenue collecting capabilities at SARS should, in the short-term, result in raising revenue more effectively than raising tax rates further. As a result, there were no changes to personal income tax brackets in 2019/20 or value-added tax (VAT).

There will be no inflation adjustments to personal income tax brackets. This will result in some South Africans moving into higher tax brackets (if their income is adjusted higher to take inflation into account) where they will pay tax at a higher rate than before. This is often referred to as “bracket creep”.

The budget includes the regular upward adjustment in taxes on alcoholic beverages (excluding sorghum beer), tobacco products and the fuel levy, with the latter increasing by 29c per litre for petrol and 30c per litre for diesel.

Consolidated revenue expected to increase as percentage of GDP

	2017/18e	2018/19f	2019/20f	2020/21f	2021/22f
Revenue	1 353.5	1 455.2	1 583.8	1 696.4	1 836.6
	28.7	28.8	29.3	29.2	29.4
Expenditure	1 543.8	1 665.4	1 826.6	1 948.9	2 089.0
	32.7	32.9	33.7	33.5	33.4
Budget balance	-190.3	-210.2	-242.7	-252.6	-252.4
	-4.0	-4.2	-4.5	-4.3	-4.0
Total gross loan debt	2 490	2 824	3 043	3 358	3 683
	52.7	55.6	56.2	57.8	58.9

Source: National Treasury

Reducing the public wag bill to curb expenditure growth

Minister Mboweni acknowledged what most local economists have been saying for a long time: that the public sector wage bill is unsustainably large. As a result, he is cutting national and provincial compensation budgets by R27 billion over the next three years.

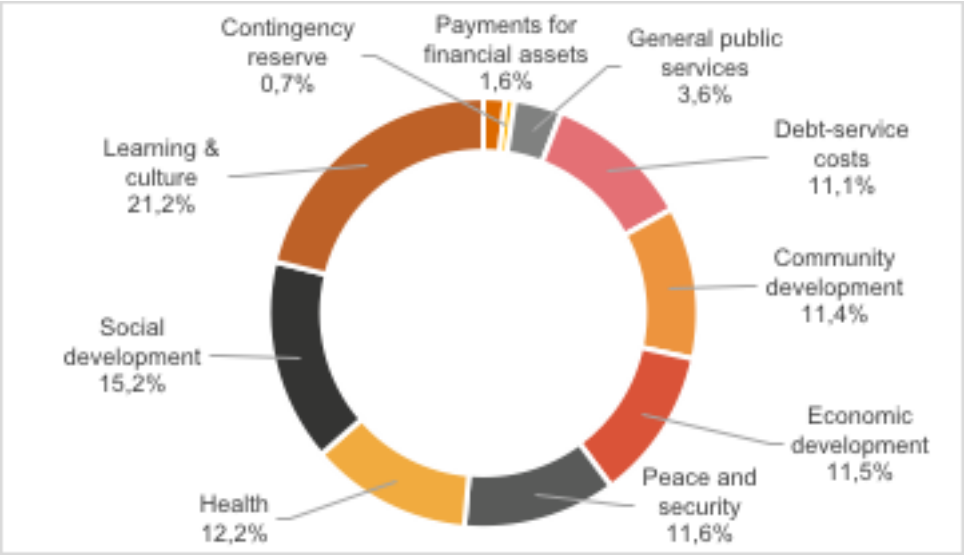
Most of these savings will come from early retirement options for older employees, with details to follow in coming weeks. Furthermore, Members of Parliament (MPs), provincial legislatures and executives at SOEs will not be receiving any increases in remuneration this year. Public entities are also encouraged to freeze the salaries of workers earning more than R1.5 million rand per annum in the 2019/20 fiscal period.

These savings are R5 billion more than the amounts set aside for Eskom.

From a function perspective, all the major expenditure items listed in the graph below will see a reduction in spending in the coming year compared to plans laid out by the MTBPS. The only exceptions are increased funding for the contingency reserve (in case of requests for financial support from SOEs) and payments for financial assets.

Of particular interest to many South Africans when considering where the country is currently standing with regards to land reform, is the plan to lower land reform and restitution grants by a combined R2 billion in 2020/21 and 2021/22.

Spending remains pro-poor and focussed on social needs



Source: National Treasury

A key focus area in this year's budget speech is the financial support that has been set aside for Eskom and the Infrastructure Fund. Because of these and other changes, the 2019/20 fiscal year is expected to see consolidated expenditure of R1.83 trillion, equal to a hefty 33.7% of GDP. Debt service costs will remain the fastest growing spending point, forecast to grow by an average of 10.7% per annum during 2019/20-2021/22.

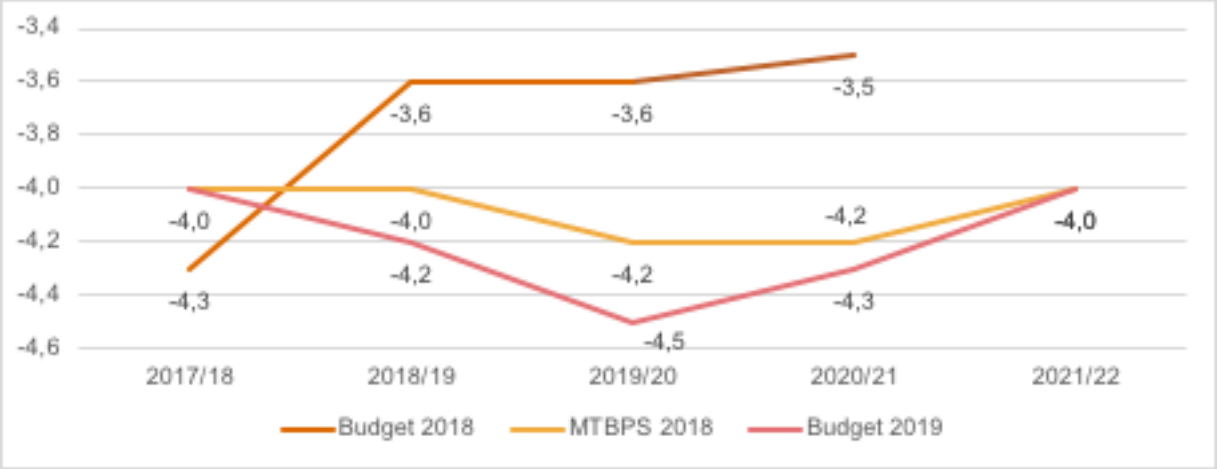
According to the Minister, the budget remains pro-poor and redistributive, and social spending (e.g. housing, schooling and education) remains the key focus of the current administration.

Wider deficit and rising debt will worry rating agencies

> South Africa's fiscal position remains weak, with sizable fiscal deficits, a large debt burden, and sizable contingent liabilities - S&P Global Ratings in November 2018

The Finance Minister did not make much reference to the budget deficit in his speech. This is surprising, given that at a planned 4.5% of GDP, the 2019/20 shortfall will be wider than previously planned and the largest since 2012. This confirms the precarious state of public finances – and the many good news items in the Budget Speech 2019 cannot patch over the wide crevice. This will likely not be positively received by rating agencies. PwC is forecasting a budget deficit of 4.7% for 2019/20.

Notably wider fiscal deficit (% of GDP) planned over medium term



Source: National Treasury

A wider deficit in 2019/20 and 2020/21 (compared to plans laid out by the MTBPS) signals an increased borrowing requirement to fund this gap. Gross national debt is now projected by the National Treasury to stabilise at 60.2% of GDP in 2023/24 compared to a ratio of 59.6% suggested in October. This breaks the 60% psychological threshold that the state has been attempting to avoid for quite some time.

SOEs must appoint Chief Reorganisation Officer (CRO) to access debt guarantees

> Pouring money directly into Eskom in its current form is like pouring water into a sieve.
> - Minister Tito Mboweni Minister

Government will set aside R23 billion per annum to financially support the reconfiguration of the power utility. This money is contingent on the appointment of an independent Chief Reorganisation Officer (CRO) at Eskom to deliver on the reconfiguration and other recommendations made by a presidential task team about the matter. The Minister made it clear that the state will not take over any of Eskom's debt.

Eskom used an additional R50 billion of the R350 billion state guarantee during the current financial year. However, the minister announced that the guarantee system – whereby the government guarantees an SOE's debt borrowings against non-payment – would in the near future include a prerequisite for appointing a CRO at the borrower towards the undertaking of a full financial and operational review. Furthermore, the state is considering ending guarantees for debt used in funding operational processes. An alternative would be to find strategic equity partners to provide the financing.

Rating agencies likely to be unhappy about deteriorating fiscal metrics

While Minister Mboweni did not spend any time in his speech talking about ratings agencies, they are important (albeit a small set of) stakeholders. The sovereign has been downgraded to sub-investment grade by S&P Global Ratings and Fitch Ratings due the deterioration in its fiscal position over the past decade. If rating agency Moody's Investors Service were to also downgrade the debt to sub-investment level, South Africa would be removed from the Citi World Government Bond Index. This would prompt asset managers and pension funds to sell billions of rands worth of domestic bonds. This would sharply increase the cost of debt and pressure the exchange rate.

Rating agencies are likely to be unhappy with the widening of the fiscal deficit, higher projected peak in public debt, as well as increased exposure to the financial woes at SOEs. The deterioration in these metrics have been a steady trend in recent years so it would not come as a shock. However, rating agencies set thresholds and do peer comparisons to determine whether a country has shifted lower in its creditworthiness to borrow internationally. If S&P, Fitch, and especially Moody's feel this is the case for South Africa, the results could be another bitter pill to swallow.

In spite of steps to address the Eskom crisis, as well as the public wage bill, PwC sees a high probability of Moody's downgrading South Africa to non-investment grade this year.