2017 budget predictions
In the 2016 Medium Term Budget Policy Statement (MTBPS), estimates for 2016/17 tax revenues were revised downwards by R23 billion to R1 152 billion. The major contributors to the downward revision were personal income tax (R12.5 billion) and VAT (R7.9 billion). Estimates for revenue from customs duties were also revised downwards (by R2.1 billion), as were revenues from excise duties (by R1.3 billion) and other taxes (by R1.9 billion). The only upward revisions were for company tax (by R2.5 billion) and dividend withholding tax (by R0.8 billion).

At the time of the MTBPS, National Treasury estimated real GDP growth for 2016 of 0.5% (revised downwards from 0.9% at the time of the 2016 Budget). National Treasury stated in the MTBPS that it expected growth to increase to 1.3% in 2017 and 2.2% by 2019 (supported by more reliable electricity supply, improved labour relations, low inflation, a recovery in business and consumer confidence, stabilising commodity prices and stronger global growth). In October 2016, the IMF expected real GDP growth of 0.1% for 2016, with a modest recovery in 2017 to 0.8%. More recently (in January this year), the Reserve Bank forecast growth rates of 0.4% for 2016 and 1.1% for 2017. With inflation forecasts for 2016 and 2017 being maintained by the Reserve Bank at much the same levels as was estimated in the MTBPS, the slightly lower than expected GDP growth is likely to translate into lower than estimated tax revenues for 2016/17. This is borne out by the revenue collections to December 2016.

Until November 2016, revenue collections were particularly poor, reflecting the slow GDP growth experienced in 2016. In December, total revenue collections increased substantially (by 12.4% on a month-on-month basis from November), largely as a result of a significant increase in VAT collections (an increase of 24.4% month-on-month from December 2015) and, to a lesser extent, as a result of a corresponding 12.5% increase in corporate income tax collections.

The volatility of these numbers (the corresponding changes month-on-month from October to November 2016 were 3.4% for total tax revenues and -2.1% for VAT) makes it relatively difficult to forecast revenue collections for the fiscal year. Nevertheless, despite the overall increase in revenue collections in December, we expect that tax collections will fall short of the revised MTBPS estimate by at least R7 billion. This will be mainly as a result of shortfalls in personal income tax, customs duties, the general fuel levy and VAT, offset to some extent by a surplus in corporate tax.

The largest obstacle to increased tax revenues is low economic growth. At the time of the 2016 MTBPS, nominal GDP growth (i.e. real GDP growth plus inflation) was estimated at 7.3% for 2017/18.

As stated above, the 2016 MTBPS put estimated tax revenues for 2016/17 at R1 152 billion, a R23 billion downward revision from the 2016 Budget estimate. Revenue collections in the final quarter of 2016 generally continued to be poor, with the result that we are of the view that tax revenues will fall short of even the revised MTBPS estimate of R1 152 billion by at least R7 billion.

Given that it is almost certain that tax revenues will fall short of the 2016 Budget estimate as well as the revised forecast in the MTBPS, it is likely that National Treasury will carry through on its proposal in the 2016 MTBPS to raise an additional R13 billion in 2017/18 through tax increases. This increase would be in addition to the tax increase of R15 billion announced in the 2016 Budget. Consequently, it is likely that additional revenue measures will be announced in the 2017 Budget to raise an additional R28 billion in tax revenues in 2017/18. The question is whether this will be sufficient, given our forecast that total tax revenues will fall short of even the 2016 MTBPS estimate by at least R7 billion, possibly resulting in tax increases over and above the R28 billion in increases that are already a certainty.

Given the lower base off which the tax revenues for 2017/18 are to be generated and the slight downward revision in nominal GDP growth forecasts by the Reserve Bank, we estimate that there will be a R9 billion gap between what was forecast in the 2016 MTBPS and our projections.

It will therefore be necessary for the National Treasury to either increase taxes beyond the R28 billion indicated in the 2016 MTBPS or to lower the expenditure ceiling even further for 2017/18. Our view is that it is likely that a combination of the two approaches will be used.

The expenditure ceiling is already under threat as a result of higher than expected inflation, particularly bearing in mind that public service wage increases are set to increase by inflation plus 1%, as well as other spending pressures. Despite this, we are of the view that government will make some cuts to the expenditure ceiling and will reprioritise expenditure in order to achieve this.

Notwithstanding this, we expect that even more tax increases are on the cards for 2017 and we could see the overall tax increases reaching R30 billion. The big challenge for government is to determine where these tax increases will come from. Our predictions in this regard are set out below.
No change is expected in the 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 stated intention to promote investment-led growth. The headline corporate tax rate is already relatively high compared to that of our main trading partners and other middle income countries. According to the Paying Taxes 2017 study, SA’s effective rate of tax on company profits is also significantly above the global and regional averages. An increase in corporate tax rates would likely have a negative impact on economic growth and investment, as it is the most distortive of all taxes. It is therefore expected that the additional tax revenues required will not be derived from this source.

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, as this would effectively result in the taxation of gains arising from inflation. We therefore do not expect any changes in to the corporate capital gains tax rate.

However, it is possible that we could see the announcement of reforms to close certain loopholes in the taxation of companies, particularly with regard to the disposal of shares. Such reforms could result in a substantial increase in revenues derived from corporate income tax.

A potential source of additional tax revenue could be an increase in the dividends tax rate of 15%. Moreover, given that it is almost certain that there will be an increase in personal income tax (with the top marginal rate likely to increase to 42%), government might seek to address arbitrage between the maximum personal income tax rate (at 42%) and the maximum effective tax rate applicable to shareholders in companies that declare all profits as dividends. This maximum effective rate, which takes into account the corporate tax rate of 28% and the dividends tax rate of 15%, is currently 38.8%. An increase in the dividends tax rate to 20% would result in a maximum effective tax rate of 42.4%, which is closer to the maximum marginal personal income tax rate of 42%.

It is difficult to project the quantum of the increased revenue that would result from a 5% increase in the dividends tax rate, since the necessary data to perform the projections are not readily available. However, as a rough estimate, such an increase could result in additional revenue of between R2.5 billion and R5 billion.

No significant changes to domestic law are expected in 2017 in relation to BEPS. It is expected that the Minister will confirm that government is fully on board with the implementation of BEPS recommendations, and that the current trajectory of implementation will continue.

South Africa has already implemented many of the BEPS recommendations (in, for example, the areas of hybrid instruments, interest limitation rules, controlled foreign companies and reportable arrangements), and it is expected that the Minister will confirm the ongoing maintenance and tweaking of these rules to address any problems or inadequacies with their implementation.

Regarding transfer pricing, we expect confirmation of the continuing work of SARS relating especially to documentation requirements and compliance.

In November last year, the OECD published the final version of the Multilateral Instrument (MLI) — a single document to amend over 2 000 international tax treaties. The four amendment areas are hybrid mismatches, treaty abuse, avoiding permanent establishment status and dispute resolution.

The MLI has been available for signature since 31 December 2016. Some 100 countries (including South Africa), representing over 2 000 DTTs, are expected to sign. We expect the Minister to use the Budget as an opportunity to confirm that South Africa will be a signatory to the MLI.
Individuals

Personal income tax

We expect a significant amount of the additional tax revenues to be raised to come from personal income tax. As was done in the 2015 Budget, it is possible that the tax rate will be increased by 1% in each of the bands with the exception of the lowest, taking the maximum marginal rate of tax to 42%. This would result in additional revenue of approximately R10 billion, with approximately half of this coming from the highest band.

Many commentators have speculated about the possibility of the introduction of a new ‘supertax’ bracket of, say, 45% on incomes over R1 million. However, it is worth noting that the introduction of such a supertax bracket would only raise an additional R6 billion over and above the additional revenues raised from increasing the rate on the current top tax bracket to 42%. In our view, it is unlikely that such a new tax bracket would be introduced because of the significant distortionary effects that this would have, including substantially increasing the difference between the top personal income tax rate and the effective corporate tax rate after dividends (38.8%).

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. It is possible that, given that capital gains tax is perceived to be a tax on the wealthy, the inclusion rate could be increased to 50% and the maximum effective rate to 20.5% (before taking into account any increase in tax rates). This would potentially raise in the region of R1.5 billion.

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. While there is a possibility that it could be announced that these reforms are proposed to be introduced, it is likely that they will not take effect this year. However, there is a possibility that the estate duty rate could be increased as proposed with immediate effect. Such an increase would not raise significant amounts of revenue, but it would be strongly symbolic and could be used to reduce resistance to an increase in the VAT rate.

The steps that were taken to address interest-free loans to trusts by deeming the interest foregone to be subject to donations tax are due to take effect on 1 March 2017. This change should result in a very significant increase in revenues derived from the donations tax. While it is difficult to estimate how much revenue this will raise, we expect that it could raise as much as R1 billion, the bulk of which would only flow to the state in March 2018.

National Health Insurance

An NHI white paper was issued in December 2015. Included in the paper are various funding options and scenarios for the NHI, including a possible payroll tax, a surcharge on taxable income, an increase in VAT, or combinations thereof. During 2016 there were no further significant developments on the NHI and we are waiting for the release of the NHI Finance Paper, which was due to be issued during the course of 2016. We do not expect any significant further developments in this regard during the course of the next year.
Indirect taxes

There is arguably scope to increase SA’s VAT rate (given the relatively low rate by international standards and the growing trend to use indirect taxes as a source of tax revenue globally). Moreover, a 1% increase in the VAT rate could raise as much as R20 billion in additional revenue. Given the significant amount of additional revenue that is being sought for 2017/18, the VAT is an attractive source 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.

Historically, government has been reluctant to increase the VAT rate due to its perceived regressive nature and political resistance. However, the 2016 Budget gave the first hint that government might be seriously contemplating a VAT increase for the first time when the following was stated:

‘Last year, government increased marginal rates of personal income tax. In future, the balance between taxes on income (direct taxes) and consumption (indirect taxes) will be an important consideration in ensuring a diversified, efficient, equitable and sustainable tax system. The current tax mix suggests that there may be greater room to increase indirect taxes, such as VAT. Any proposals along these lines would need to be accompanied by measures to improve the pro-poor character of expenditure programmes so that the fiscal system remains progressive.’

In light of the above statement, we believe that there is an even chance that the VAT rate will be increased by 1% to 15%. However, 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 grants, an expansion of the basket of zero-rated goods, or a combination thereof. In our view this would cost in the region of R5 billion, resulting in a net impact of approximately R15 billion. The major uncertainty in this regard is whether the current political environment would allow the space for the Minister to make such a bold move. If not, government will have little choice but to utilise a much wider range of tax instruments to raise the required revenues.

Securities transfer taxes

One possibility available to government to obtain additional tax revenues would be to increase the securities transfer tax rate from its current level of 0.25%. Doubling this rate would potentially raise additional tax revenues of at least R5 billion. However, the distortionary implications of any such increase on stock markets would require careful consideration. Nevertheless, it might be an enticing option should government need to close a small funding gap.

Carbon tax

While a draft Carbon Tax Bill was issued for comment in November 2015, substantial changes are expected and a further draft of the Bill has yet to be issued. The legislation is expected to be processed during the course of 2017 and we expect the tax to be implemented in 2018.

Other environmental taxes

In the 2016 Budget, it was announced that a tyre levy would be introduced with effect from 1 October 2016. This was subsequently postponed to 1 February 2017 for further consultation and has now become effective from that date. It is expected that the tyre levy will contribute R600 million in revenues.

The plastic bag levy, incandescent light bulb levy and vehicle emissions tax were increased in 2016 and no further increases are expected in the 2017 Budget.

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 general fuel levy was increased by 30c/l in 2016 and by a similar amount in 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 not increased, we expect to see a significant increase in the general fuel levy of 50c/l or possibly even more. An increase of 50c/l would raise additional revenues of approximately R10 billion.

The RAF levy was increased by 50c/l in 2015 in order to support the RAF, an increase of nearly 50%. The RAF continues to experience cash shortfalls and, taking into account that the RAF levy was not raised last year, we can expect that it will be raised this year. In this regard, we anticipate an increase of 10c–15c per litre.

Excise duties on tobacco and alcohol are a perennial soft target for tax increases. Smokers and drinkers can expect to see above-inflation increases in these taxes. These increases will make a small contribution to the increased tax revenues being sought.

The 2016 Budget proposed the introduction of a tax on sugar-sweetened beverages with effect from 1 April 2017. The consultation process is ongoing and, due to the fact that the Customs and Excise Act will need to be amended and go through the parliamentary process, the implementation date is expected to be postponed to later in 2017. While no estimates of the expected tax revenues have been published by government, industry estimates suggest that the direct revenues would amount to R6.7 billion and the net revenues after taking into account the impact on other taxes would amount to R3.8 billion.