PwC Comment on the 2016 Budget Speech

Personal Income Tax

A surprise announcement in the Budget Review was the increase in the CGT inclusion rate for individuals (from 33.3% to 40%), companies (66.6% to 80%) and trusts (66.6% to 80%). This narrows the arbitrage between capital and revenue gains for companies and trusts almost to the point where one wonders why one should distinguish between them at all. Also, South Africa has relatively high inflation (we've just seen a revision to 6.1%) and it has long been pointed out to National Treasury that taxing capital gains is akin to taxing inflation. The situation now becomes worse where these gains are taxed at higher effective rates. For example, in the UK they have indexing to prevent the taxation of inflation when taxing capital gains.

Greg Tarrant, Associate Director, PwC Tax

Many individuals will be relatively pleasantly surprised by the tax changes applicable to them as announced by Finance Minister Pravin Gordhan today. While many commentators predicted an increase in the marginal tax rates across most tax brackets other than the lowest one of 18%, this has not materialised and the marginal tax rates applicable to each bracket have in fact remained the same. What has been adjusted, as is always the case, are the income levels at which each rate becomes applicable but at the same time the personal tax rebate has also been slightly increased. Given these changes, while taxpayers in the lowest tax bracket will be paying up to 11.8% less tax (on taxable income of R85,000) even taxpayers with taxable income of R1m will be paying marginally less tax (0.6%) than what they currently are.

Barry Knoetze, Partner, PwC Tax

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While the news as regards personal income tax is generally good news when seen in isolation, it must be seen in context as in contrast to that, depending on taxpayers' personal circumstances, they could be hit by increases in other taxes, for example, the increase in the capital gains tax inclusion rate (from 33.3% to 40%, with an increase in the annual capital gains tax exclusion from R30,000 to R40,000), the usual increases in the fuel levy and sin taxes and an increase in transfer duty for sales in excess of R10 million.

Berry Knoetze, Partner PwC Tax

Despite expectations that the marginal personal income tax rates would be increased, it was proposed that they remain the same for all income tax brackets. However, only limited relief is provided for fiscal drag. Fiscal drag relief entails adjusting personal income tax brackets and rebates for inflation so that an individual's purchasing power remains the same from one year to the next. In this regard, to reduce the impact of inflation on lower- and middle-income earners, the Budget Review proposes that the primary rebate be adjusted by 1.8 per cent and the bottom three income brackets be adjusted by 3.4 per cent. No such relief from fiscal drag is provided to the higher income tax brackets, effectively resulting in these tax payers facing a bigger tax burden.

Karen Botha, PwC Tax Senior Manager

Over the last 2 weeks, conflicting messages have been doing the rounds regarding the Retirement Reform and the possible repeal of legislation that was promulgated earlier this year.

The Revenue Laws Amendment Bill, 2016 provides for the postponement of the annuitisation requirement for provident funds for two years, until 1 March 2018.

The Taxation Laws Amendment Act, No. 25 of 2015, with an effective date of 1 March 2016 entails changes to the tax treatment of contributions to retirement funds, providing for a uniform tax treatment of contributions to pension funds, provident funds and retirement annuity funds. These changes are still going ahead.

Tax is no longer a factor that should be taken into account when remuneration packages are structured. The ideal remuneration structure should promote simplicity, flexibility and better understanding of the employee's remuneration package. It should be encouraging Financial Wellness through training and education and the offering of lifestyle choices, rather than any perceived paternalistic choices.

Karen Botha - PwC Tax Senior Manager

Corporate Tax

Corporate taxpayers are currently required to include 66.67% of a capital gain determined in terms of the Eighth Schedule to the Income Tax Act in their taxable income which is then subject to tax at the current corporate tax rate of 28%. This results in an effective tax cost of 18.67% of the capital gain. It has been proposed that, for tax years commencing on or after 1 March 2016, corporate taxpayers include 80% of a determined capital gain in their taxable income resulting in an effective tax rate of 22.4% on the capital gain. In effect, only 20% of a determined capital gain, in the context of a corporate taxpayer, remains exempt from tax in South Africa. If the trend of increasing the inclusion rate annually continues into the future, a 100% of a determined capital gain will be subject to tax leaving only certain capital receipts and accruals (which are not subject to capital gains tax) and certain exempt items escaping tax.

Mike Benetello, Partner, Mergers & Acquisitions, PwC Tax

The Budget Review for 2016 includes a number of statements that indicate that certain transactions (including financing transactions) are to be reviewed and if necessary measures put in place to address tax avoidance areas. Most notably, mention is made of so called "subscription and buy-back" transactions which National Treasury indicate in their view should be regarded as share sales subject to tax. In such a transaction, a prospective purchaser will subscribe for shares in a target company and the target company in turn will use such subscription proceeds to buy-back existing shareholder shares. Currently, the seller of shares will receive a tax exempt dividend on selling their shares (and if a corporate seller there is also no dividends tax liability!). It is considered that if amendments are made to give effect to the view of National Treasury that there will be a significant reduction in these types of transactions which clearly have a tax benefit attaching to them when compared to a direct sale of shares.

Mike Benetello, Partner, Mergers & Acquisitions, PwC Tax

International Tax

As expected, Finance Minister Gordhan has used this opportunity to highlight the ongoing targeting of base erosion and profit shifting (BEPS) by multinational corporations. However, this will come a no surprise to corporates since SA has repeatedly affirmed that we are already well into "implementation" mode when it comes to the global anti-BEPS proposals. Areas that are specifically highlighted are: transfer pricing and the introduction of "country-by-country" reporting, treaty shopping, and interest deductions.

No new major tax amendments are proposed in the international tax space. However, the Budget Speech does indicate that further tweaking of the existing rules around hybrid debt instruments and controlled foreign companies are expected. As expected, the scrapping of the new withholding tax on services has been proposed.

Osman Mollagee, Partner, International Tax, PwC

Sugar tax

It is clear that the Government is serious about social well- being and need to align this with the policy paper issued by The Department of Health.

However, the proposed sugar tax will have a negative impact on beverage companies. The question that arises is why only on beverages and not other industries?

Tyre Levy

The proposed tyre levy is part of Government's initiatives leading to a cleaner environment. This is also part of the reduction of waste and to encourage recycling. This should also lead to some job creation. However, we will need to understand how this will be regulated.

Mornay Schafer, Associate Director, PwC Tax

Hybrid debt instruments

The proposal to provide an exclusion for subordination agreements from the application of the hybrid debt instruments legislation is welcomed. These provisions are anti-avoidance provisions that essentially treat interest on certain debt instruments as dividends in the hands of both the issuer and the holder of the debt instruments. Due to the wording of these provisions, subordination agreements are negatively impacted, despite the fact that these agreements serve commercial purposes only and not tax avoidance purposes.

In addition, it is interesting to note that consideration is to be given to cross-border hybrid arrangements where there is the possibility of avoiding tax both in South Africa and the foreign country. Examples of these would be where a tax deduction arises in South Africa for an interest expense whilst the foreign country regards the amounts in question as tax exempt dividends under their domestic legislation or alternatively a situation where the foreign country allows a deduction for a particular amount of interest under their domestic legislation whilst South Africa regard the amount as an exempt dividend due to the hybrid debt instruments legislation.

Mike Benetello, Partner, Mergers & Acquistiions, PwC Tax

Indirect Taxes

Notional input tax on goods containing gold

The prior amendment to the definition of second-hand goods which was intended to avoid abuse, however, created an anomalous situation for legitimate traders of second-hand jewellery, gold coins and computers (i.e. goods containing gold). It is a welcomed proposal and will hopefully achieve tax parity for the affected industries and prevent tax cascading.

Taxation of non-executive directors' fees

This proposal is very important in providing certainty on whether VAT and/or PAYE is payable. We are hopeful that it never gets to the point where both taxes are imposed. It is important to note that the imposition of VAT on directors' fees would result in companies having a VAT cost on such expenditure as the full amount of VAT incurred on directors' fees may not be deducted in full.

Loyalty programmes

Loyalty programmes are complex from a VAT perspective. They are designed to incentivise customers to repeat purchase. This proposal should aim to align the VAT treatment to that of discounts which is currently contained in the VAT Act. It is indeed a very progressive proposal to address the potential anomalous tax implications. It is very interesting to see that SARS and NT are cognisant of the advancement of vouchers in the commercial environment and taking the necessary steps to align the VAT law to hopefully ensure that VAT is not a cost.

Indirect exports

The proposal is a practical approach to ensure that the deemed VAT charged on exports are effectively reversed when a vendor can satisfy all the documentary requirements imposed by SARS. This has always been SARS' approach and this proposal will provide the legislative basis. Depending on how one interprets the Export Regulation, it is arguable that this amendment is not required.

Alternative documentary proof

Section 16(2)(g) of the Value-Added Tax Act is yet to come into effect (1 April 2016) and it is welcoming to see that NT recognises that the Commissioner should have a wider discretion to allow alternative documentary proof to substantiate the deduction of input tax. Currently, the discretion is limited to circumstances where the vendor is unable to obtain the documents prescribed in section 16(2)(a) to (f). This initial amendment was very limited and not very progressive and is actually perceived as an attempt to limit the outcomes of the SA Jazz Festival case. A practical approach is required here as all that a vendor needs to demonstrate that it is a legitimate expense and that the VAT was legally charged and paid.

Rodney Govender, Associate Director, PwC Tax