PwC Budget Review - Highlights 2020

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Tax

Personal Income Tax

Given the worsening economic realities still facing the Minister of Finance this year, it came as a pleasant surprise that he provided 5.2% adjustments to the individual tax brackets and rebates, resulting in real personal income tax relief for the already stretched individual taxpayers.

The net result is that, with effect from 1 March 2020, the maximum rate of 45% applies to taxable income in excess of R1,577,301 (up from R1,500,000) while the lowest rate of 18% applies to taxable income up to R205,900 (up from R198,850) with similar adjustments to the brackets in between. There will also be 5.2% increases in the primary, secondary and tertiary rebates, resulting in the tax-free threshold increasing from R79,000 to R83,100 for taxpayers under 65 years of age.

It was widely expected that the medical tax credit available to taxpayers who are members of medical aid schemes would not be increased, however, it has in fact been increased nominally from R310 to R319 per month for each of the first 2 dependents and from R209 to R215 per month for every subsequent dependent.

As regards the much talked about taxing of foreign remuneration that comes into effect on 1 March 2020, the proposed exemption will be increased from R1 million to R1.25 million. The Minister also announced a comprehensive review of the pay-as-you-earn system with a view to implementing a more modern automated process. Details in this regard are, however, unclear at this stage.

Barry Knoetze, Associate Director, PwC

Streamlining Personal Income Tax Compliance

A welcome announcement in the Budget is that the legal framework and administration of pay-as-you-earn will be reviewed with a view to implementing a more modern, automated process. This is likely to be of benefit both to employers and employers by simplifying the administrative burden of the employees' tax system.

Greg Smith, Senior Manager, PwC Tax Technical

Reviews of Corporate Tax Incentives, and Sunset Dates

With a view to ensuring that Government gets enough "bang for its buck" from corporate tax incentives, the Budget makes a significant announcement regarding reviews of these incentives.

In this regard, it is proposed that a 28 February 2022 sunset date be introduced for tax incentives relating to airport and port assets, rolling stock and loans for residential units. In addition, all of these incentives will be reviewed in order to determine whether they should be extended.

In a similar vein, the incentive relating to industrial policy projects will not be renewed beyond 31 March 2020, and the urban development zone incentive will be extended for one year while it is reviewed.

It was also announced that, generally, sunset dates will be inserted in all incentives where they do not currently exist in order to prevent incentives continuing indefinitely without adequate foresight.

Greg Smith, Senior Manager, PwC Tax Technical

Limitations on assessed losses

From a corporate tax perspective, a significant development is that, with effect for years of assessment ending on or after 31 December 2021, companies will only be able to claim assessed losses against 80% of taxable income.

The effect of this proposal is that companies with assessed losses will be required to pay corporate income tax on at least 20% of their taxable income, despite the level of assessed losses brought forward. This would have an impact on the recognition of deferred tax assets in the financial statements of companies.

Greg Smith, Senior Manager, PwC Tax Technical

Value-Added Tax

Revising the definition of "telecommunication services" for electronic services regulations

The definition of "telecommunication services" in the electronic services regulations contains an incorrect reference resulting in unintended consequences. This referencing error will be rectified.

Reviewing the VAT accounting basis for electronic services intermediaries

Under the electronic services provisions in the VAT Act, suppliers of electronics services or intermediaries (in certain circumstances) are required to account for VAT on these supplies into South Africa.

The current provisions result in an anomaly in that the suppliers of electronic services can account for VAT when payment is received, whereas intermediaries must account for VAT on the full value of the supply when an invoice is issued. To rectify this anomaly, it is proposed that intermediary suppliers of electronic services be allowed to account for VAT when payment is received.

Changing the VAT treatment of transactions under the corporate reorganisation rules

Section 8(25) of the VAT Act ensures that transactions entered into between a group of companies have no VAT consequences provided the relevant rollover relief provisions of the Income Tax Act are met. The income tax relief provisions may not apply to the transfer of certain assets, which means that their transfer will also not qualify for the VAT relief. This limitation creates unintended consequences as the entire transaction could qualify for VAT relief under the going-concern provisions, but are excluded because the transaction falls within the ambit of the corporate reorganisation rules.

It is proposed that changes are made in the relief provisions in section 8(25) of the VAT Act to address these limitations.

Reviewing section 72 arrangements and decisions

Section 72 allows the Commissioner a discretion to make an arrangement or decision regarding the application of the VAT Act to specific situations where difficulties, anomalies or incongruities are experienced by a vendor. In 2019, amendments were made to this dispensation impacting vendors who currently have such an arrangement or decision from SARS, including the introduction of an end date to any current rulings that were issued by SARS under the previous provisions of section 72.

It is now proposed that the impact and the role of arrangements and decisions issued prior to 21 July 2019 be reviewed to ascertain whether such arrangements should be discontinued or extended in accordance with the new provisions of section 72.

This proposal provides no indication that National Treasury is considering amending the law to cater for prior arrangements which no longer qualify under the new provisions of section 72. It is uncertain what the scope of the review by National Treasury envisages, and whether such review will address the deficiencies contained in the VAT Act.

Clarifying the VAT treatment of irrecoverable debts

National Treasury has proposed clarifying the value to be declared by a vendor in instances where such vendor deducted input tax but has not paid the full consideration within a 12-month period. The VAT Act currently provides that the vendor will be required to account for output tax on the portion of the consideration that is unpaid.

It is therefore unclear what aspect of legislation National Treasury will be clarifying.

Measures to address undue VAT refunds on gold

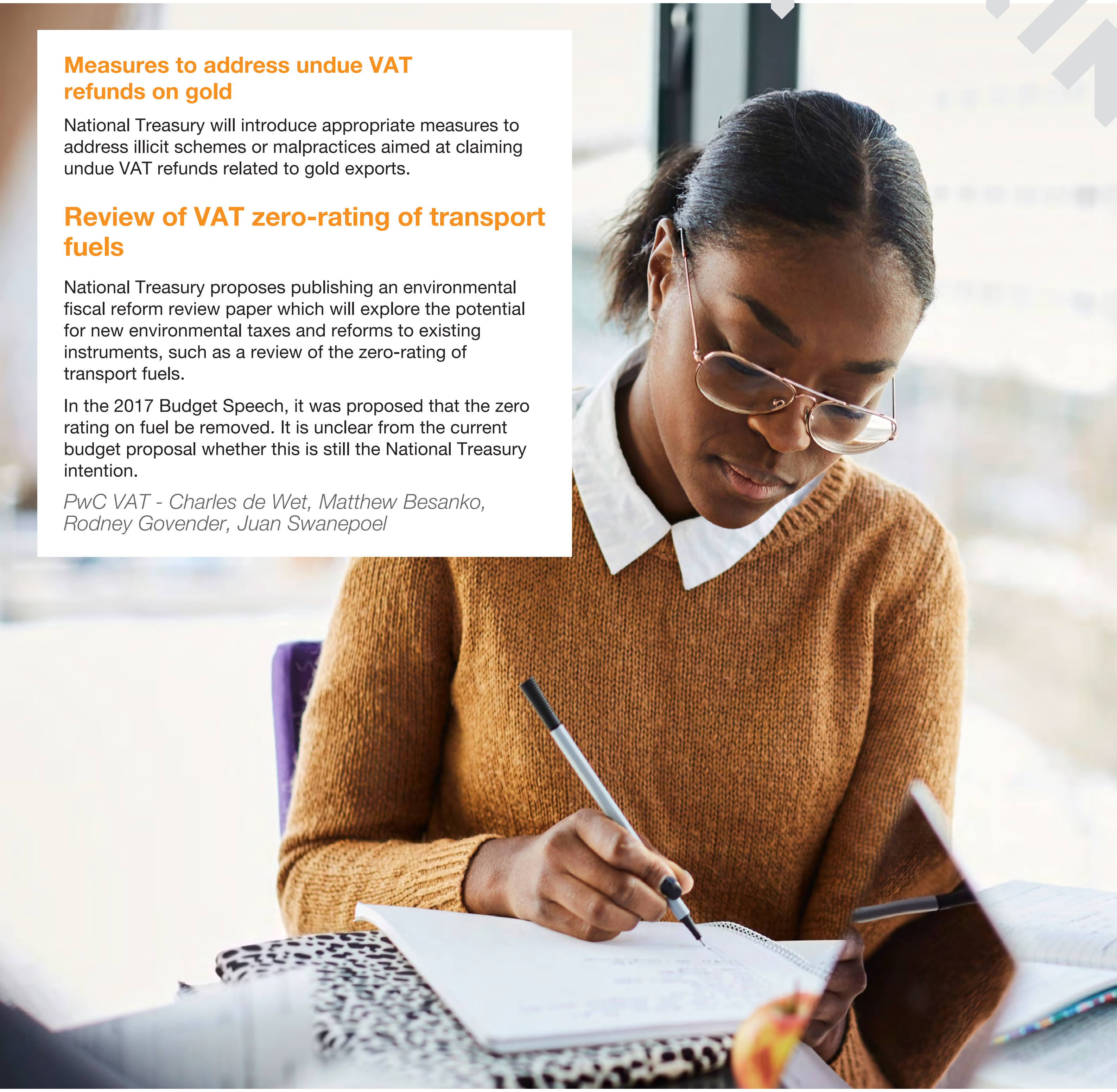
National Treasury will introduce appropriate measures to address illicit schemes or malpractices aimed at claiming undue VAT refunds related to gold exports.

Review of VAT zero-rating of transport fuels

National Treasury proposes publishing an environmental fiscal reform review paper which will explore the potential for new environmental taxes and reforms to existing instruments, such as a review of the zero-rating of transport fuels.

In the 2017 Budget Speech, it was proposed that the zero rating on fuel be removed. It is unclear from the current budget proposal whether this is still the National Treasury intention.

PwC VAT - Charles de Wet, Matthew Besanko, Rodney Govender, Juan Swanepoel



Carbon Tax

In line with the provisions of section 5 of the Carbon Tax Act the carbon tax rate will be R127 p/tCO2e for the 2020 tax period.

The draft regulations for the trade exposure and performance allowances will be revised and gazetted in March 2020. A notice for the renewable energy premium credit will be published by National Treasury in March 2020 and in April 2020 DEFF will publish the methodology and accounting framework for greenhouse gas emissions sequestration.

The carbon fuel levy of 7 cents for petrol and 8 cents for diesel will remain unchanged for the 2020 tax period. A technical note outlining the methodological approach and administrative process for future alignment with increases in the carbon tax rate will be published by June 2020.

Limited recovery of the carbon tax costs for regulated fuels is proposed. The cost recovery mechanism is proposed as a deduction against the carbon tax liability of petroleum refineries. Government will publish the applicable rates for specific regulated fuels in a notice in the gazette.

National Treasury has kept to its intention to review the effectiveness of the Carbon Tax structure after three years. The design of Carbon Tax will be reviewed to ensure that current measures are effectively contributing towards cost-effective emissions reduction and assisting South Africa's transition to a low-carbon economy.

National Treasury has announced that Environmental Fiscal Reform mechanisms, by way of an extension of existing environmental taxes will be explored.

National Treasury has highlighted key instruments for exploration which include the intention to restructure the general fuel levy to include a local air pollution emissions component, and an evaluation of the current design options allowing for an annual carbon dioxide tax on vehicles that will be administered through road pricing charges. The intention behind the introduction of road pricing charges is aimed at alleviating traffic congestion.

Furthermore, National Treasury has committed to assessing the current inefficiencies around fossil fuel subsidies as well as the implementation of product taxes on electrical and electronic waste. Aligned with carbon pricing and environmental taxation, National Treasury will further consider incentives for companies that make use of more fuel-efficient vehicles.

PwC Carbon Tax - Herman Fourie, Nadia de Wet

Customs and Excise

Sin Tax Changes

Inflationary increases in Excise duties on tobacco and alcoholic products of between 4.4 and 7.5 per cent from 26 February 2020.

General fuel levy increases by 16 cents per litre and road accident fund levy increases by 9 cents per litre on 1 April 2020.

A new tariff subheading and excise category in respect of heated tobacco products is created. This new heading/category is to be taxed at 75% of the equivalent cigarette excise with immediate effect.

Additional proposals

Government intends to introduce an excise tax on electronic cigarettes in 2021.

Proposed introduction of export tax on scrap metals of between R1 000 and R8 426 per ton. Consultations will begin today and are to be concluded by the end of May 2020.

Government proposes increasing the vehicle emissions tax rate for passenger cars to R120 per gram of carbon dioxide emissions per kilometre (gCO2/km) and R160 gCO2/km for double cabs. The threshold will be adjusted from 120 gCO2/km to 95 gCO2/km for passenger vehicles to align with the Euro 6 emission standards. These amendments will take effect from 1 April 2020.

Government proposes an increase to the incandescent light bulb levy by R2 from R8 to R10, effective 1 April 2020, to encourage the uptake of more energy-efficient light bulbs.

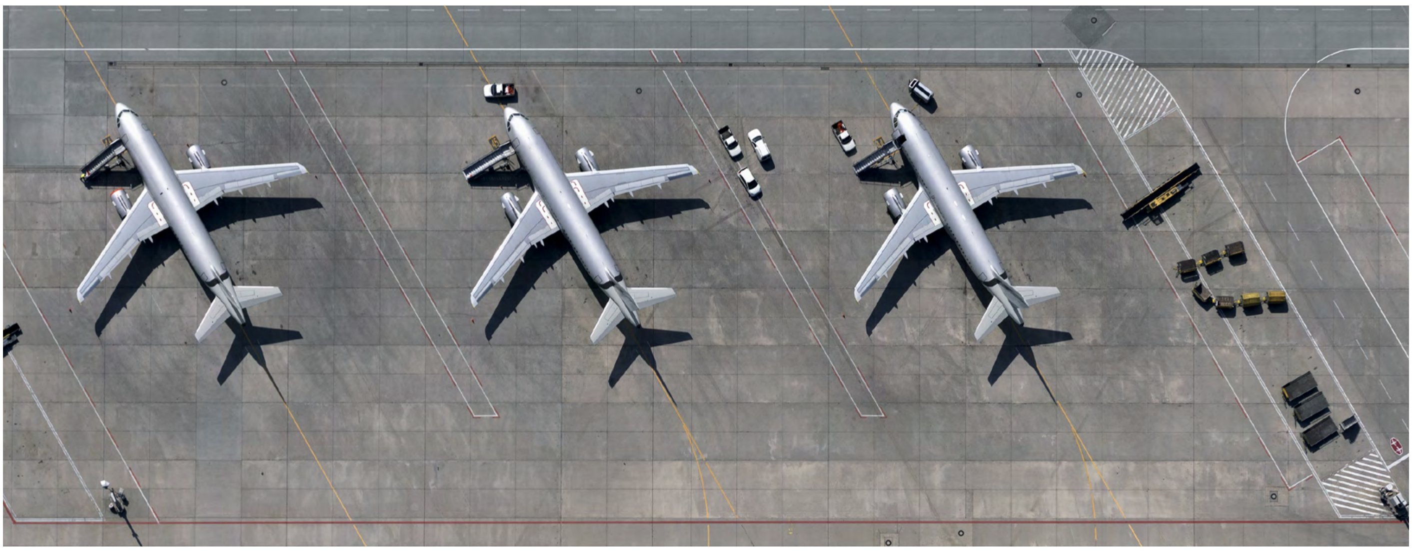
Proposal to change the Customs and Excise Act to allow for the publication of tariff determinations (rulings) and rules prescribing the circumstances in which such publication can take place, the kind of publication and the manner of publication.

It is proposed, in relation to duty-free purchases at duty free shops, that SARS be permitted to disclose information regarding duty-free purchases by diplomats to the Director-General of the Department of International Relations and Cooperation.

Progress with the review of the diesel refund administration: SARS recently published draft diesel refund rules and notes to the Customs and Excise Act for public comment. The draft presents a provisional outline for the review of the diesel refund administration to facilitate further industry engagements during 2020.

Government proposes raising the plastic bag levy from 12 to 25 cents per bag effective 1 April 2020. A review of the current levy, including clarification of the tax treatment of compostable bags, will be undertaken.

PwC Customs and Excise - Herman Fourie, Hennie Engelbrecht, Morne Gentle



Economics

Budget 2020: High Noon

It's high noon and South Africa is facing off with the ratings agencies

By PwC Strategy& economists Lullu Krugel & Christie Viljoen

Key points

- Finance Minister Tito Mboweni delivered his Budget Speech 2020 to Parliament on February 26.
- National Treasury now expects real GDP growth of only 0.9% this year and 1.3% in 2020, compared to forecasts of 1.2% and 1.6%, respectively, announced in October 2019.
- A downside scenario with mounting distress at State-Owned Enterprises (SOEs) could result in a recession in 2020.
- Suggestions for growth-boosting reforms include resolving the electricity issue and changes to benefit small business, amongst others.
- Fiscal revenues will be R63.3 billion less in 2019/2020 compared to the forecast ofFebruary 2019.
- Apart from the usual adjustments to fuel and sin taxes, National Treasury is looking at increased efficiencies as the South African Revenue Service (SARS) to boost revenue in the medium term.
- No changes were announced to tax rates despite widespread expectation of an increase in value-added tax (VAT).
- The government to discuss with labour unions what options are available to reduce staff costs and move the public sector wage bill towards a more sustainable trajectory.
- National Treasury is planning for R160 billion in staff savings over the medium term, thought this still needs to be negotiated with labour unions.
- Consolidated government spending will grow by an average of 5.1% over the medium term largely as a result of fast-rising debt service costs.
- There is no immediate detail on funding for the state bank and sovereign wealth fund.
- Fiscal budget deficit will widen to 6.8% of GDP in 2020/2021 – the largest shortfall since 1992.
- Public debt will breach 70% of GDP.
- The risk of South Africa losing its investment-grade credit rating has become more pronounced.
- While Moody's Investors Service will find some good news in the Budget Review 2020, most of the key ratings-related elements remain very negative.
- Action is needed to right the fiscal ship – and don't count on a bailout.

Weak economic growth scenarios, as expected

Budget statements have in recent years perennially made downward revisions in economic growth projections. Disappointing growth outcomes compared to official forecasts is partly attributed to the inability to implement planned structural reforms that would have delivered improved growth outcomes.

As such, it was unsurprising that the Budget Review 2020 again cut growth projections. The National Treasury now expects real GDP growth of only 0.9% this year and 1.3% in 2020, compared to forecasts of 1.2% and 1.6%, respectively, indicated in the Medium-Term Budget Policy Statement (MTBPS) presented less than four months ago and lower than the 1.2% for 2020 projected by the SARB in January of this year. Electricity loadshedding was provided as a key reason for the disappointing growth environment.

As always, the National Treasury provided its views on what is needed to improve the state of the local economy. This includes resolving the electricity issue, increasing access to rail and broadband spectrum, reforms to benefit small business, modernising the foreign exchange control system to attract more investment, and improving the composition of fiscal spending.

The National Treasury considered what the impact would be of opposing forces – stressed State-Owned Enterprises (SOEs) and planned structural reforms – on the economic growth outlook. Under a scenario where reforms are implemented at a moderate pace, economic growth would move closer to the 2.0% level in 2021 compared to the currently projected 1.6%.

Slow implementation of reforms was highlighted as a serious risk to the growth outlook. A scenario where mounting distress at SOEs further erode the fiscal position, and global growth falters due to trade disruption, a recession could materialise in 2020.

The global outlook is clouded by the adverse effect on trade of US-China tensions, the impact on supply chains of the COVID-19 situation, and a weakened outlook for economic growth in South Africa's largest trading partners.

Figure 1: Real GDP growth (%) projections revised lower

Source: National Treasury

Revenues disappoint – but luckily no VAT hike

There is a strong relationship between (nominal) economic growth and fiscal revenues. As such, the weaker economic outlook translates into a deteriorated income outlook for the state. PwC expected revenues in the 2019/2020 to be as much as R65 billion lower than planned in February 2019. The National Treasury reported this figure at R63.3 billion – a number exceeding the under-collection in 2009/2010, in the wake of the global financial crisis.

Slow nominal income growth and a rising unemployment rate have adversely affected personal income tax receipts. Growth in value-added tax has slowed since the one percentage point increase in the VAT rate in 2018 while VAT refunds have also been higher than expected. Corporate tax collections – historically a volatile component of state income – is expected to underperform significantly in 2019/2020.

Local fuel prices will increase by 25c/litre from April this year to adjust for inflation. The plastic bag levy will almost double from 12c to 25c from April. As always, taxes on tobacco products and alcoholic beverages will increase – many by more than inflation, as is the norm. Heated tobacco products and e-cigarettes will also be taxed from 2021.

To boost tax revenues over the medium term, the National Treasury is pinning its hopes on a revitalised South African Revenue Service (SARS). The government is looking at re-establishing integrity and compliance function, restoring public trust and employees' confidence in the entity, creating a new office focussed on HNWIs, and getting support from the re-established Davis Tax Committee to reduce tax leakages, customs fraud and trade mispricing. SARS is also reviewing its procurement processes.

On another positive note, no changes to current tax rates are envisaged over the medium term. In light of a warning on October 2019 that increases in tax rates could be used the address the fiscal (im)balance, many analysts warned that an increase in the value-added tax (VAT) rate was on the cards for the 2020/2021 fiscal year. Nonetheless, despite wide expectation of higher tax rates, the finance minister announced no tax increases in the interest of supporting economic growth.

Furthermore, the National Treasury is implementing above-inflation relief on personal income taxes. Tax brackets and rebates will be increased by 5.2% compared to forecast inflation of 4.4%. Someone earning R265,000 per annum will see their income tax reduced by over R1,500 a year. Lower income earners will receive the bulk of this progressive benefit: someone earning R10,000 a month will pay 10% less tax while someone earning R100,000 a month will pay about 1.5% less.

Table 1: Revenues rising slowly, expenditure reaching R2 trillion in 2021/2011r

R trillion/percentage of GDP	2018/2019	2019/2020e	2020/2021f	2021/2022f	2022/2023f
Revenue	1.45	1.52	1.58	1.68	1.79
	29.4	29.4	29.2	29.2	29.2
Expenditure	1.64	1.84	1.95	2.04	2.14
	33.4	35.7	36.0	35.4	34.9
Budget balance	-0.197	-0.33	-0.37	-0.36	-0.35
	-4.0	-6.3	-6.8	-6.2	-5.7
Total gross loan debt	2.78	2.94	3.56	4.00	4.38
	56.7	61.6	65.6	69.1	71.6

Source: National Treasury

Plans for some saving on the public sector wage bill

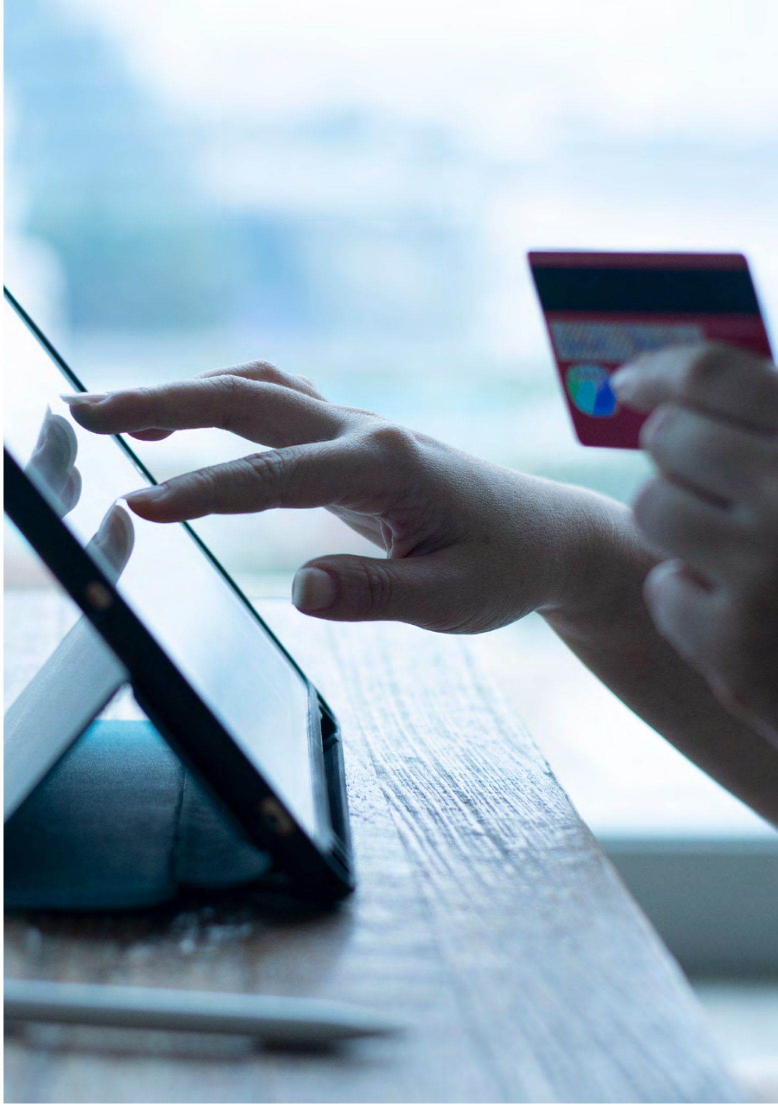
Less money to spend means making changes to expenditure. Spending has moved away from capital investment towards consumption spending over time. One key challenge on the consumption side is the public sector wage bill. The National Treasury reported that real (i.e. inflation-adjusted) public sector salaries have increased by 40% over the past 12 years “without equivalent increases in productivity”. The remuneration growth has been “increasingly out of line with the rest of the economy”.

The government – who is currently locked into a three-year wage agreement with its workers – plans to discuss with labour unions what options are available to reduce staff costs and move the public sector wage bill towards a more sustainable trajectory. Options include changes in cost-of-living allowances, pay progression and other benefits. The Budget Review 2020 did not refer to the possibility of reducing staff numbers.The finance minister instead indicated a need to increase staff in important areas like education, police and healthcare.

If the proposed wage reductions can be implemented, real consolidated compensation spending could decline by one percentage point an average of over the medium term. National and provincial governments are proposed to receive R37.8 billion less for the compensation budget in 2020/2021 and a total of R160 billion over the three-year budget period. If this materialises, it will support in limiting expenditure growth. The details still need to be negotiated with labour unions, so the entire R160 million will probably not be secured.

Total consolidated government spending will grow by an average of 5.1% over the medium term largely as a result of fast-rising debt service costs. This growth rate takes into account R261 billion in programme and wage bill spending reductions., At the same time, R111 billion in additional allocations have been made, including R60 billion towards the financial needs of Eskom and South African airways.

There is no immediate detail on how a proposed state bank and sovereign wealth fund will be financed. President Cyril Ramaphosa indicated recently that the finance minister would give more information on these two entities in his speech. The state bank was billed as a state-owned financial institution that will be operated as a commercial bank. The sovereign wealth fund could be financed by a variety of possible funding sources, with more to be announced in the MTBPS 2020.



Little impact on budget balance from MTBPS warnings

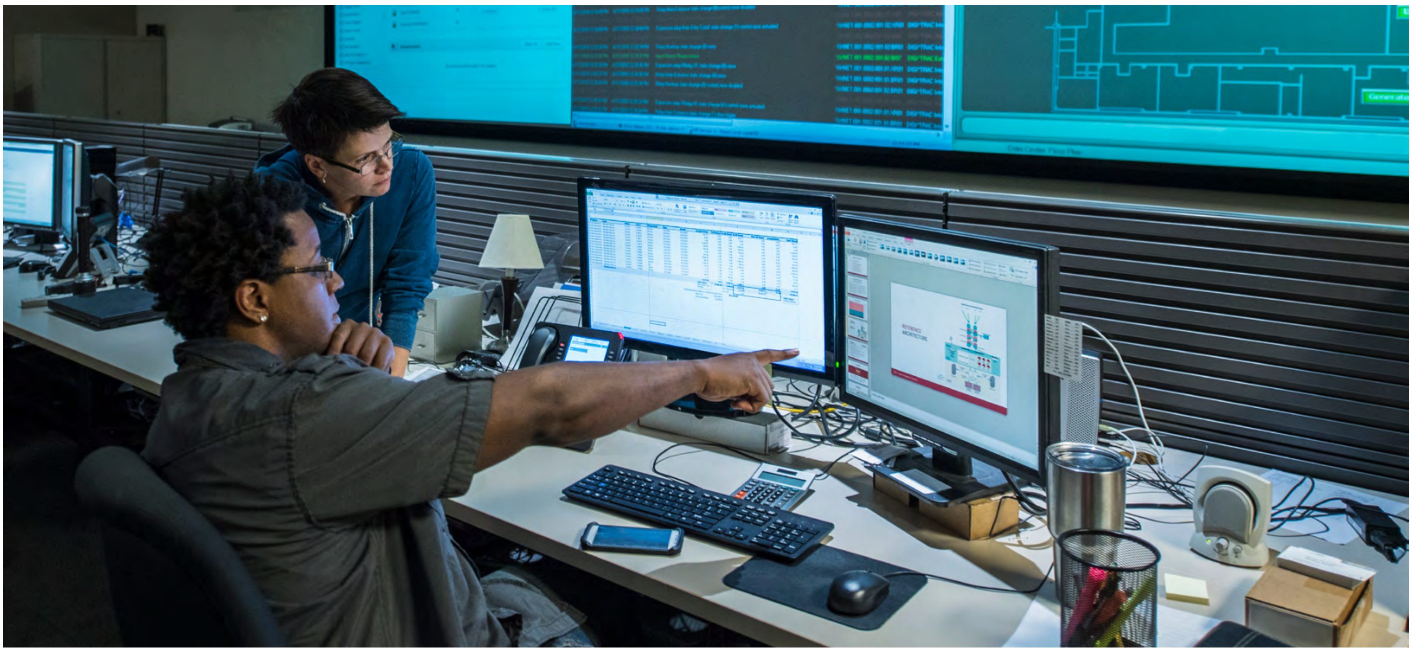
The MTBPS 2019 set out plans for the central government to achieve a main budget primary balance – i.e. revenue equal to non-interest expenditure – by 2022/23. Given the above, the National Treasury had to admit that this aim is now out of reach. The departure point for their goal is turning out to be a bad starting point, with the fiscal deficit set to widen to 6.3% of GDP – in line with PwC expectations – in the current financial year.

Taking into account the above information in income and expenditure, the National Treasury estimates that the fiscal budget deficit will widen to 6.8% of GDP in 2020/2021. This is a massive departure from a figure of 4.3% presented a year ago. The proposed fiscal deficit will be the largest since 1992. The reality of this situation is that the dire MTBPS 2019 – aimed at scaring key people into realising how desperately the country needs to make changes to the economy and fiscal scenario – has largely fallen on deaf ears.

Figure 2: Budget deficit (% of GDP) widening to largest in almost three decades

Source: National Treasury

Budget Review 2020 also listed some risks to this already bleak outlook. These include insufficient progress in righting the ship at Eskom, an underwhelming outcome with the renegotiation of public sector remuneration, and a lack of clarity on a solution to the fiscus-draining e-tolls. Progress on all three of these points have been slower than required to reduce their impact on the fiscal situation.



Public debt heading only one way: up

It is important to note that the pro-consumer fiscal stance – not increasing VAT and above-inflation PIT relief – is a short-term boost to the economy with long-term implications. Easing the household tax burden today requires increased government borrowing tomorrow, and a higher debt burden for taxpayers to carry in the future. By not further cutting spending (over and above the ones discussed above) and/or lifting tax rates, the National Treasury has kept the budget deficit very wide.

Current deficit projections are not significantly different form those presented in the MTBPS 2019. As such, the public debt trajectory is also not much different from that envisioned some four months ago. Nonetheless, the outlook is much worse than it was a year ago, and public debt is rising to above 70% of GDP. This is already notably higher than a level of 60% of GDP which the International Monetary Fund 9IMF) has in the past referred to as "uncomfortable".

Figure 3: Public debt (% of GDP) outlook keeps deteriorating

Source: National Treasury

High noon: ratings and bailouts

The Budget Review 2020 acknowledges that "[t]he risk to South Africa's remaining investment-grade credit ratings has become more pronounced. Indeed, the road ahead for the country's sovereign ratings is all but rosy." Moody's Investors Service – the only rating agency still providing South Africa with an investment-grade rating – already has the country on a negative outlook.

Was there good news for rating agencies in Budget Speech 2020? Yes, but not a lot. Efforts to address the public sector wage bill will be a positive, if it is indeed implemented. So too all the intentions for reforms going forward – this has been an important downgrade buffer for Moody's for some time. However, the realities are that economic growth forecasts have been revised lower, expenditure has not been trimmed significantly, and the budget deficit is ballooning. As a result, public debt is rising rapidly, with little prospect of the trajectory looking any better come MTBPS 2020.

Moody's is scheduled to publish its next ratings review of South Africa during March 2020. There is a widely held view amongst economists that the agency will downgrade South Africa this year, with some suggesting that it could happen next month already. Irrespective of the exact timing, the loss of South Africa's last investment-grade rating is quite certain to happen. Something needs to be done, and very quickly, to avoid this. It is High Noon at the Last Chance Saloon.

But don't count on a bailout. Every few months, local media reports on comments and speculation about an IMF bailout for South Africa to cope with its fiscal, debt and ratings malaise. Sovereign states like South Africa are able to approach the IMF for financial and technical (non-financial) support during both calm and stormy conditions. In troubled times, the IMF can consider a bailout, or what the multilateral organisation calls "crisis lending".

It is important to note that South Africa is not in crisis lending territory. The country is not experiencing any of the major risks that would let it quality: a natural disaster, large swings in commodity prices, capital-flow volatility, or a balance of payments crisis. Furthermore, crisis lending is only provided upon request and South Africa has not asked for a bailout. Even if the country does make such a request, a bailout is not a cash gift, it is a loan and increases public debt.

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