2020 Budget predictions

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Economic and fiscal policy

GDP growth

PwC wish

Our biggest wish would be for the Minister of Finance to announce that the economic reform plan released by the Minister in August 2019 and updated in October 2019 has been adopted by the government and that implementation will be fast-tracked. These reforms are urgently needed to get economic growth to a level that equates to population growth (2020 will be the sixth consecutive year of real GDP per capita decline due to population growth outpacing economic growth).

PwC prediction

National Treasury's growth forecasts will be revised slightly lower compared to the numbers in the 2019 Medium Term Budget Policy Statement (MTBPS). This is based on GDP and other economic data released since October last year that suggest a continued sluggish economy.

Expected forecasts are:

- 2019: 0.4% (from 0.5% forecast in October 2019)
- 2020: 1.0% (1.2%)
- 2021: 1.4% (1.6%)
- 2022: 1.6% (1.7%)

Any comments about economic growth forecasts will be somewhat downbeat. However, the National Treasury will no doubt provide a long list of positive developments and planned reforms aimed at boosting economic growth in the medium term. This is a staple of budget speeches: downward revisions in growth projections followed by a litany of good news items that will ostensibly ensure that the next budget views the growth outlook more favourably.

Fiscal balance

PwC prediction

The 2019 Budget indicated that 2019/2020 would see a fiscal deficit equal to 4.5% of GDP. The MTBPS took into account an increase in expenditure and slower growth in revenue, suggesting a deficit equal to 5.9% of GDP in 2019/2020. Based on tax collections to date, weaker economic growth assumptions, and assuming no significant change in expenditure, the 2019/2020 budget deficit could be expected to come in at 6.3% of GDP (this would be the largest shortfall since 1992).

If the Minister of Finance had been able, during the current fiscal year, to address the large public sector wage bill by, for example, implementing a wage freeze during the year, this would have resulted in a saving of around R46 billion, which would have reduced this projected deficit by 0.9 percentage points to 5.4% of GDP. Making a measurable impact on the fiscal balance in 2020/2021 will require action from the government on the revenue side. We expect that measures will be announced that will aim to secure an additional R25 billion in additional revenue through a combination of increased efficiencies at SARS, limited relief for fiscal drag in personal income tax (PIT) and an increase in the VAT rate.

Expenditure

PwC wish

There is now no doubt that significant action is needed on the expenditure side of the budget. This, in turn, would require significant savings on the public sector wage bill. Jobs and remuneration are almost a no-go for the current executive given the tight relationship between the ruling party and labour unions. A strong message and action on curbing staffing costs is needed to increase confidence in the Ramaphosa administration's ability to improve the fiscal situation.

PwC prediction

The government will need to find R25 billion in expenditure savings in 2020/2021 to make a measurable impact on the fiscal balance. These savings would need to be secured at the margin of many different spending points: there are no big once-off steps that can be taken, especially in light of the funding needs of SOEs. The Minister of Finance will need to look at cutting all unnecessary expenditure across all government departments. A great deal of this has, however, already been done in recent years.

Debt

PwC prediction

The trajectory for government debt is a product of the National Treasury's fiscal deficit projections. Forecasts in the MTBPS were highly distressing: public debt is expected to reach above 70% of GDP by 2022/2023. Should any announced measures to increase revenues and reduce expenditures be realised, this could lead to a slightly more favourable trajectory. Debt payments will, however, continue to grow at a fast pace (faster than overall expenditure) in the years ahead and will continue to crowd out other important expenditure.

SOEs

PwC prediction

Eskom: the MTBPS promised that the power utility would be separated into three units with independent boards by March 2020. An update on progress in this regard is expected prior to the Budget and ahead of the March 2020 deadline for the step. The separation into three units is among a list of requirements set by National Treasury before the government would consider any form of debt relief for Eskom. It is very possible that the Budget will not allocate additional financing to Eskom over and above the money allocated by the MTBPS.

SAA: Budget 2020 will need to explain the financial future of the state airline after the National Treasury failed to raise R2 billion in necessary funding for the airline (the DBSA was convinced to pitch in the finances in January this year).

Credit ratings

PwC wish

Moody's could return its negative outlook on South Africa to a stable outlook if the Budget outlines credible steps towards fiscal and general economic reform. For this to happen, the government will need to make significant changes on the expenditure side.

PwC prediction

Moody's Investors Service stated in late January that it is looking for signs of a credible medium-term vision for South Africa and its finances. The MTBPS did not provide such a credible outlook. Instead, it showed how fiscal metrics would deteriorate if no action is taken to stimulate the economy and reduce government spending. This sets the stage for Budget 2020 to show how the ship will be steered back on course. Increased revenues and lower expenditure in 2020/2021 could, if realised, be viewed favourably. Moody's has been very patient with South Africa, much more than other major rating agencies, and could hold off until later this year to make a change to its sovereign ratings.

Taxes

2019/20 tax revenues

PwC prediction

In the 2019 MTBPS, estimates for 2019/20 tax revenues were revised downwards by R52.5 billion to R1 369.7 billion. Significantly, the downward revision arose from revisions in revenue collection estimates from all three of the major tax types (i.e. personal income tax with a downward revised estimate of R25.3 billion, company tax R10.6 billion and value-added tax R12.1 billion). The only taxes in respect of which revisions were made upwards in the MTBPS were dividends tax (R0.1 billion) and specific excise duties (R4.2 billion).

Based on revenue collection figures to the end of December 2019, the situation appears to have deteriorated even further. We now expect tax revenues for this year to be between R57 billion and R65 billion lower than the 2019 Budget estimate (i.e. between R4.5 billion and R12.5 billion lower than the revised estimate in the MTBPS).

The primary contributor to the forecast additional shortfall is VAT, with corporate tax collections likely to be more or less in line with, and personal income tax collections marginally better than, the revised estimates in the MTBPS.

Given that VAT collections serve as an indicator of consumption (and therefore economic activity), of particular concern is the fact that there has been a steady decline in growth in domestic VAT collections over the period between April and December 2019. A similar picture appears from import VAT collections, where growth was negative between October and December.

This clearly indicates that the weak economy (and consumption specifically) is having an effect on tax revenues. Given the downward trends evident in the data, it is possible that the situation could still deteriorate further, especially in light of some recent poor trading updates from retailers. We are therefore of the view that it is likely that the additional revenue shortfalls for the fiscal year will be towards the upper end of the range of between R4.5 billion and R12.5 billion.

2020/21 tax revenues

PwC wish

Additional fiscal measures to reduce the deficit are inevitable. Ideally these should come from expenditure reductions (particularly in the wage bill) and improvements in the performance of SARS in collecting revenues, rather than tax increases.

Significant increases in personal income tax have taken place in the past few years (through increases in the top marginal rate and through fiscal drag). This has, however, failed to translate into increased revenues. This tends to indicate that the previous increases in personal income taxes are themselves having a negative effect on economic growth and have largely become self-defeating.

An increase in the corporate income tax (CIT) rate will, in all probability, have an even more pronounced negative effect on economic growth.

Although the only other option – to raise the VAT rate – would be difficult from a political perspective on the basis of the perceived regressive nature of VAT and its effect on the poor, we believe that this would have the least negative impact on SA's flailing economy, and should therefore be the preferred option should government wish to increase revenues by raising taxes.

PwC prediction

In the 2019 Budget, tax revenues for 2019/20 were estimated at R1 422.2 billion. In the MTBPS, this estimate was significantly reduced by R52.5 billion to R1 369.7 billion.

In the MTBPS, the following were stated as reasons for weak revenue growth:

- A poor economic outlook, with job losses, lower wage settlements and smaller bonuses reducing personal income tax collection;
- Reduced profitability in a difficult trading environment, resulting in lower than expected corporate income tax collections; and
- Weak household consumption, which has an effect on domestic value-added tax collections.

As per our forecasts above, we estimate that revenues will ultimately fall short of the MTBPS estimate by a further R12.5 billion, resulting in total tax revenues for 2019/20 of R1 357.2 billion. If we assume a tax buoyancy of 1 and that, for the 2020/21 fiscal year:

- inflation will approximate 4.7%, and
- real GDP growth will approximate 1%, we estimate that, in the absence of any additional revenue raising measures, total tax revenues for the 2020/21 fiscal year will approximate R1 434.6 billion, some R26.3 billion lower than the MTBPS forecast.

As is apparent from the above:

- total revenues for the 2019/20 fiscal year are likely to be approximately R65 billion lower than was estimated in the 2019 Budget; and
- total revenues for 2020/21 are likely to come in lower than estimated in the MTBPS (by about R26.3 billion).

We do therefore expect that measures will be taken in the 2020 Budget to raise significant amounts of additional revenue, as well as to reduce expenditure.

It should further be noted that these measures will be in addition to any measures that will be taken pursuant to the announcement in the 2019 Budget that additional revenues of R10 billion would be raised in the 2020/21 fiscal year.

The MTBPS indicated that R50 billion in additional measures were required to achieve the objective of a primary balance by 2022/23. Adding the additional shortfall of R26 billion in total revenues for 2020/21 (which includes the R10 billion in additional revenue measures already announced in the 2019 Budget) translates to total additional measures of approximately R75 billion that would be required.

We don't expect that government will seek to achieve all of this in the 2020 Budget. However, we do expect that they will be looking for between R50 billion and R60 billion.

The question then arises as to how this will be achieved.

Expenditure

PwC wish

Given the current lack of fiscal space that the government finds itself in, it is hoped that the 2020 Budget will announce significant measures to cut all unnecessary expenditure across all government departments, with a particular focus on the wage bill. It is accepted that this might not be an easy task, given political sensitivities, but is absolutely necessary to put the fiscal framework on a sustainable footing.

PwC prediction

There is broad consensus, even within the government, that urgent and meaningful steps must be taken in order to rein in expenditure, and it is expected that announcements will be made in the 2020 Budget in this regard. Although the government may be constrained in this regard, we estimate that approximately R25 billion in further expenditure reductions may be sought in 2020/21.

Efficiency of the South African Revenue Service (SARS)

PwC wish

As stated in the 2019 MTBPS, significant governance failures, the dismantling of critical organisational arrangements and the loss of experienced staff at SARS have all contributed to poor revenue collection in recent years. It is hoped that, under the new Commissioner, the operations of SARS will be revitalised and efficiencies increased with a view to improving the performance of the revenue authority.

PwC prediction

Although quantifying the difference that such performance improvement could make to revenue collection figures could be difficult, we estimate that such efficiencies could result in additional revenues of at least R10 billion in 2020/21 and would expect that a portion of the additional fiscal measures will take this form.

Corporate income tax

PwC wish

Tax rate

Any increase in the CIT rate 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 objective of promoting economic growth. The headline corporate tax rate is already relatively high compared to our main trading partners and other middle-income countries. South Africa has a relatively high CIT tax burden at 4.3% of GDP.

It has become clear that company profits are under pressure, with the result that CIT collections are performing well behind forecasts (as per the MTBPS, the estimate for CIT collections for 2019/20 were revised downwards by some R10.6 billion). An increase in the corporate income tax rate would only exacerbate this situation. CIT is also the most damaging of the taxes on economic activity and investment.

We are therefore of the view that any increase in the CIT rate should, in order to avoid the negative impact such an increase would have on economic growth, be avoided.

CGT

In 2016, the effective capital gains tax rate for companies was increased from 18.6% to 22.4% (or from 66.6% to 80% of the income tax rate). Any further increase would effectively result in the taxation of gains arising from inflation. In our view, this would be extremely ill-considered.

PwC prediction

No changes are expected to the general corporate tax rate of 28%, nor to the inclusion rate for capital gains tax.

Tax base

Further reforms aimed at broadening the tax base are expected. This could include further limitations on the deduction of interest.

Dividends tax

PwC wish

Aside from the negative impact an increase in the dividends tax rate could have on fixed investment, any increase in the dividends tax rate, without an accompanying adjustment to PIT rates, would create opportunities for tax arbitrage between different tax types. On the basis that an increase in PIT rates would be ill-advised, it follows that an increase in the dividends tax rate would also be inappropriate.

PwC prediction

The dividends tax rate was increased from 15% to 20% in the 2017 Budget (in combination with an increase in the maximum marginal PIT rate to 45%). We don't expect further changes to the dividends tax rate in the 2020 Budget.

Personal income tax

PwC wish

Tax rates

In the 2019 Budget, almost no relief was given for fiscal drag.

Currently, the PIT tax burden is at record levels at 10.1% of GDP. This is significantly above the average for OECD countries (8.2% of GDP) and far above the average for developing countries. The PIT base is under severe strain, high levels of PIT have the effect of limiting economic growth and investment, and there has been growing slippage in compliance levels.

A greater portion of this tax burden has also been shifted to higher-income earners. Thus, for example, in 2018, 67.6% of PIT was assessed to individuals with taxable incomes exceeding R500 000 per annum (this represents a substantial increase from 2014, when 57.3% of PIT was assessed to individuals with a taxable income exceeding R500 000). There is growing evidence that this situation is having the effect of alienating high income earners (who are also invariably highly skilled and internationally mobile and who, effectively, would pay tax at lower rates outside SA), thereby depleting the SA tax base.

Ideally, in order to give the South African consumer a boost (and thereby boost the economy), full fiscal drag relief should be given to individual taxpayers. This applies both in respect of PIT rates and in respect of the medical tax credit.

PwC prediction

Tax rates

Despite the factors mitigating against an increase in the PIT rate, as well as the significant increases in PIT in recent years, it is likely that the 2020 Budget will not provide significant fiscal drag relief. Although such a measure would have a significant adverse effect on economic growth, we are of the view that government will adopt this course of action in order to make a likely increase in VAT more palatable.

It is expected that this could raise an additional R13 billion in tax revenue.

Additional revenues would also be expected from the limitation of the exemption for South African expatriates to R1 million with effect from 1 March 2020, although these amounts are likely to be relatively small.

Medical tax credit

In the 2018 and 2019 Budgets, it was stated that below-inflation increases in the medical tax credit over the three years following 2018 would assist government in funding the rollout of National Health Insurance. It is expected that this policy will be continued and, as was the case in the 2019 Budget, taxpayers can expect to see no increase in medical tax credits.

It is expected that this will raise an additional R1 billion in tax revenue.

CGT

In 2016, the maximum effective capital gains tax rate for individuals was increased from 13.7% to 16.4% (or from 33.3% to 40% of the income tax rate). No further changes were made to the inclusion rate since then, although the introduction of the new 45% band in 2017 had the effect of increasing the maximum effective CGT rate to 18%. It is possible, given that CGT is perceived to be a tax on the wealthy as well as pressures on government to increase taxes on the wealthy, that the inclusion rate could be increased to 50% (with the result that the maximum effective CGT rate for individuals would increase to 22.5%). The additional revenue raised as a result of such a measure would not be substantial, and would be unlikely to exceed R2.5 billion.

Estate duty and donations tax

PwC prediction

In the 2018 Budget, the rate of estate duty on estates with a value above R30 million was increased from 20% to 25% of the value of the estate that exceeds R30 million.

Any increases in estate duty and donations tax are unlikely to raise any 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.

VAT

PwC wish

There is no doubt that an increase in the VAT rate will have an adverse effect on consumption and therefore economic growth. In addition, the increase will be acutely felt by the poor, for whom any increase in the VAT rate translates into increased hardship. Ideally, there should be no need to increase any tax rates, including the VAT rate.

The above having been stated, government currently finds itself in a situation where it will likely be forced to raise revenue from one or more of the major taxes (i.e. CIT, PIT and VAT). On the basis that an increase in the rate of VAT will have the least harmful effect on the overall economy and its ability to raise substantial amounts of revenue with relatively small tax increases, it should be the preferred instrument for raising additional tax revenues.

Moreover, South Africa's VAT rate is still relatively low by international standards, and there is a growing trend globally towards indirect taxes as a source of tax revenue.

Luxury VAT rate

We note the suggestion from some quarters that a higher VAT rate be introduced for luxury goods. In this regard, we are of the view that warnings from the Davis Tax Committee to the effect that multiple VAT rates add significantly to the complexity of the VAT system and the administrative burden, while raising relatively small amounts of additional revenue, should be heeded.

PwC prediction

VAT rate

Although the increase in the VAT rate in the 2018 budget resulted in a significant public outcry on the basis of the perceived regressivity of VAT, the significant pressure on the fiscus to raise revenue is likely to prompt a further increase in the VAT rate.

We estimate that an increase in the rate from 15% to 16% will result in additional revenue of approximately R25 billion.

Luxury VAT rate

We do not expect the introduction of higher VAT rates for luxury goods.

Ad valorem duties

PwC prediction

As an alternative to a higher VAT rate on luxury goods, 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.

The benefit of *ad valorem* duties over VAT is that the tax is collected at the stage of production and the number of participants in the supply chain who are needed to administer the system is limited (as opposed to VAT, which requires participation by all vendors in the value chain).

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. We do not, however, anticipate that such a measure will result in significant additional revenues.

Fuel levies

PwC prediction

General fuel levy

With the exception of the 2019 Budget, the general fuel levy has been increased substantially over the past five years in real terms as a means of raising additional tax revenues. 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. Moreover, with the likely VAT increase in the 2020 Budget, this attention is likely to increase. As such, it may no longer be seen as a viable option for government to raise additional revenues.

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

The Road Accident Fund (RAF) is projected to become government's largest contingent liability by 2021/22, despite receiving an ever-increasing share of combined fuel tax revenues.

In the MTBPS, it was stated that the liability of the RAF is expected to grow from R341 billion in the 2019/20 fiscal year to R605 billion in 2022/23 as a result of claims against the fund growing significantly faster than the increases in the RAF fuel levy, with the effect that there has been insufficient growth to offset growth in liabilities.

It was further stated in the MTBPS that it was envisaged that the growing gap between revenue and liabilities would require a transition to the Road Accident Benefit Scheme (RABS), which would provide a more equitable and sustainable support to victims.

Given the significant projected increases in the liabilities of the RAF and the delay in the introduction of RABS, we anticipate an above inflation increase of around 30c/l in the RAF levy.

Transfer duties

PwC prediction

In 2015, a new maximum rate of 13% was introduced for properties above R10 million. In 2017 the tax-free threshold was increased from R750 000 to R900 000. Further changes in 2020 are considered unlikely, especially given the state of the residential property market in which property prices are under severe pressure.

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 at the rate of 2.21c/g of sugar content that exceeds 4g per 100ml.

The HPL was not intended to be a revenue raising measure, and we therefore do not believe that it would be appropriate to raise the rate beyond an inflationary adjustment.

It is accordingly anticipated that the Budget will see an inflationary increase in the levy to between 2.29c/g and 2.33c/g of sugar content that exceeds 4g per 100ml.

Excise duties

PwC prediction

Excise duties on tobacco and alcohol have traditionally been a soft target for increased taxes.

We expect that any increases in excise taxes are however, unlikely to exceed inflation on tobacco and alcohol, which is currently slightly higher than CPI.

Carbon tax

PwC prediction

The carbon tax introduced in 2019 is unlikely to have a significant effect on overall revenues, but will contribute a relatively small amount of about R3 billion in revenue.

Other environmental taxes

PwC prediction

The 2018 Budget saw substantial increases to the plastic bag levy (50%), the environmental levy on incandescent light bulbs (33%) and the vehicle emissions tax. These taxes raise small amounts of revenue and are unlikely to be increased in the 2020 Budget in light of the review of environmental taxes announced in the 2019 Budget which is yet to be completed.

No changes are also expected to the electricity levy in light of the introduction of the carbon tax.

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