PwC Budget Highlights 2021

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Major Tax Announcements

**Tax revenue**

As predicted, tax revenues are expected to be R100 billion better than those forecast in the MTBPS and there will be no significant tax increases, with the R40 billion announced in the MTBPS being withdrawn. This is welcomed and will support the economic recovery.

*Kyle Mandy, Head of Tax Policy, PwC*

An additional R3 billion is allocated to SARS for investment in technology. This is crucial to enable SARS to improve collections and close the tax gap and is to be welcomed.

*Kyle Mandy, Head of Tax Policy, PwC*

**Venture Capital**

In 2009, the Government introduced a venture capital company (VCC) incentive in order to encourage retail investments in small business. Following a full assessment of the incentive by the National Treasury, this year’s budget has announced that the incentive will not be extended beyond 30 June 2021.

As per the Budget Review, it appears that the main concern that National Treasury has is with its additionality – the incentive has, according to Treasury, not resulted in significant investments in small business that would not have already taken place even without the incentive, and has merely “created a significant tax deduction for wealthy taxpayers”.

While we believe that some of the concerns of Treasury are valid, and noting that Treasury does wish to ensure that it is getting “bang for its buck” with all incentives (especially in light of the policy imperative to lower the CIT rate by broadening the tax base and limiting incentives), we also believe that the incentive could have been further adjusted in order to ensure the required additionality, and that ultimately many small businesses have lost an important source of funding as a result of the loss of this incentive.

*Greg Smith, Senior Manager PwC Tax Technical*

**Corporate Tax and incentives**

It appears that any roll out of any specific business incentives has been sacrificed for a decrease of 1% in the corporate tax rate to 27%. This is, however, in line with the trend of terminating ineffective incentives or incentives that have seemingly been abused. Positive on the deferral of interest limitations and assess loss measures, as well as the extension of the UDZ incentive and learnership allowances with a consideration of the R&D regime.

*Tapie Marlie, PwC Tax Director*

**A commitment to lower Corporate (and Personal) Income Taxes over the medium term**

The National Treasury has, for some time, been all too aware of the fact that South Africa’s Corporate Income Tax (CIT) rate (at 28%) is relatively high when compared with similar countries and our trading partners, and that this acts as a hindrance to economic growth by reducing competitiveness. It must, as stated in the budget this year, be remembered that although CIT is paid by a company, the burden of a high CIT rate is ultimately borne by three parties – the owners of capital (who have less to invest in the economy), labour (through lower wages) and consumers (through higher prices). Aside from this, a higher CIT rate also creates an incentive for profit shifting to jurisdictions with lower tax rates, thereby affecting SARS’ efficiency in administering CIT and ultimately reducing revenue collections overall.

With the above in mind, it was announced in last year’s budget that the government would introduce measures aimed at restructuring the CIT system over the medium term, by broadening the base, with the aim of reducing the CIT rate. The effects of the COVID-19 pandemic have, fortunately, not resulted in government backtracking on this broad proposal, and this year’s budget again makes a renewed commitment to this policy imperative.

Accordingly, the implementation of the relevant measures announced in last year’s budget (i.e. the limitation of the use of assessed losses and the revision of interest deduction limitation rules, as well as a comprehensive
review of incentives) will continue. This is coupled with a renewed commitment to enforcement and administration, which will go a long way to addressing South Africa’s tax gap.

We welcome this approach, which takes account of the effect of higher taxes on economic growth, the behavioral responses of taxpayers to higher tax rates, inequality and fairness, and SARS’ administrative capacity. The commitment to lower CIT rates (and also, concomitantly, overall personal income tax rates) is, as stated in the budget, indeed conducive to broad-based economic growth by both facilitating economic growth and competitiveness and avoiding complicated incentives for specific sectors or groups of taxpayers.

Greg Smith, Senior Manager PwC Tax Technical

**Personal Income Tax**

Despite the impact of COVID-19 on revenue collection, the Minister of Finance announced that there would be an above inflation 5% adjustment to the individual tax brackets and rebates.

The net result is that, with effect from 1 March 2021, the maximum rate of 45% applies to taxable income in excess of R1,656,600 (up from R1,577,300) while the lowest rate of 18% applies to taxable income up to R216,200 (up from R205,900) with similar adjustments to the brackets in between. There will also be an approximate 5% increase in the primary, secondary and tertiary rebates. The tax-free threshold has now increased from R83,100 to R87,300 for taxpayers under 65 years of age.

It was once again widely expected that the medical tax credit available to taxpayers who are members of medical aid schemes would not be increased. They have however been increased nominally from R319 to R332 per month for each of the first 2 dependents and from R215 to R224 per month for every subsequent dependent.

However, there is some additional tax to pay for certain income earners, in the form of an increase in the cap for Unemployment Insurance Fund contributions. Whereas for the last several years the earnings threshold remained stable at R14,872 per month, this has now been increased to R17,711.58 monthly. What this means is that you will still...
pay 1% of your salary towards UIF, as will your employer, but the contribution will be capped at R177.11 per month if you earn R17 711.58 per month or more.

There are several tax changes in the budget that will affect individuals. National Treasury has committed to reviewing the rules around travel and working from home in light of the COVID-19 pandemic. This is welcome, but given that consultation will only start in 2021/2022, the changes will likely only come into effect in the 2023 tax year at the earliest, which may be a long time for those who need relief as a result of the new way of working. There will also be some changes to long service awards, where awards in forms other than an asset may be treated as long service awards.

A number of other more specific changes have been proposed and these include changes to long service awards, the tax treatment of retirement fund lump sums accruing after the retiree has ceased to be a tax resident in South Africa, perceived ETI abuse schemes and the tax treatment of contributions to retirement funds with self-insured risk benefits.

Barry Knoetze, PwC Tax Associate Director and Claire Abraham, PwC Tax Senior Manager

Tax collections in the mining industry

Despite an extremely challenging year, a boost from corporate income tax receipts from the mining sector contributed to the higher than expected revenue collections which were above the 2020 MTBPS estimate.

The expected increase in the collection of mineral and petroleum royalties in respect of 2020/2021 is further evidence of the improved profitability of mining companies. In the 2020 Budget Review estimates, the budget estimate for mineral and petroleum royalties was R12 697 million, whereas, the revised budget estimate in the 2020/2021 Budget Review amounts to R14 343 million. It is also worth noting that the revised budget estimate for 2020/2021 is a 21.2% increase from the mineral and petroleum royalties revenue outcome of 2019/2020.

This clearly indicates that the mining sector performed well under difficult times, as a valuable contributor to the South African economy. The resilience showed by the mining sector can be attributed to the following:

- Gains in commodity prices, in particular the increase in the platinum group metal (PGM) basket prices and investors fleeing to gold as a safe haven investment amid the COVID-19 pandemic and global trade tensions.
- A weaker rand.
- A lack of tax shields, in the form of assessed losses and capital expenditure carried forward from previous years of assessment, which decreased taxes collected from the sector in previous years. This however highlights one of the biggest concerns in the mining industry, i.e. capital investments by the mining sector have only marginally increased even though the sector experienced significant increases in profitability.

Laetitia Le Roux, PwC Tax Partner (Energy, Utilities and Resources)

International Tax

On the international tax front there are no major tax reforms announced but rather relatively minor clarifications and ‘fine tuning’ of certain existing rules. These include:

- The diversionary rules which were reintroduced in 2016, specifically relating to the sale of goods by controlled foreign companies to South African resident connected persons, are expected to be ‘tightened’ in order to restrain abuse by certain outbound groups.

As part of the 2020 legislative cycle certain amendments to the existing ‘participation exemption rules’ were introduced as a result of the softening of the exchange controls regulations around ‘loop structures’. Following the relaxation of the exchange control regulations, to some degree, by the South African Reserve Bank at the beginning of 2021, it is now intended to ‘fine tune’ the interaction between the relevant tax rules at play in relation to such structures. Whilst such fine tuning is welcomed and necessary the impact of this and whether equitable by taxpayers is uncertain at this stage.

Further, given a delay in progressing efforts in examining income tax challenges associated with digitalisation of the economy due to the pandemic, South Africa (being one of the members of the Steering Group of the Inclusive Framework on BEPS) has as part of this Budget reannounced its commitment to getting this done, and perhaps even potentially considering a unilateral approach should the delay continue.

Michael Butler, PwC International Tax Partner; Asif Joosub, Associate Director PwC International Tax; Jason Daniel, Manager PwC International Tax

Short-term insurance

As a result of concerns in the short-term insurance industry relating to the inequitable tax treatment that can arise with the sale of an insurance book of business, it is proposed that section 28 be amended to clarify the tax treatment of the transfer of liabilities as part of the transfer of short-term insurance business.

Keshia De Gouveia, PwC Senior Manager (Financial Services Tax)
Value-Added Tax & Indirect Taxes

Zero-rating of super fine maize meal
Under the current wording contained in Schedule 2, Part B of the Value-Added Tax Act, 1991 (the VAT Act) 18 grades of maize products are zero rated. The current wording does not explicitly include super fine maize meal but there is an argument that it could be zero rated as super fine maize meal is maize meal. It is now proposed that the item relating to maize meal as set in Schedule 2, Part B of the VAT Act be amended to specifically include super fine maize meal. This will now undoubtedly allow for super fine maize meal to be zero rated. This is a positive amendment as it accords with the zero rating of merit goods.

VAT treatment of temporary letting of residential immovable property
Under the current economic climate, property developers have found it difficult to dispose of developed residential property. Previously the VAT Act made provision for property developers to rent out unsold residential property on a temporary basis with no adverse VAT consequences for a period up to three years. This concession came to an end on 1 January 2018 resulting in significant cash flow difficulties for developers.

An announcement was made in the 2010 Budget Review to investigate and determine an equitable value and rate of claw-back for developers where unsold residential property is rented as the current treatment is disproportionate to the exempt temporary rental income. It’s assumed that the 2010 Budget Review gave rise to the concession, which was subsequently repealed, and it appears that the National Treasury is now contemplating a more sustainable solution. It’s proposed that the VAT Act be amended although it’s unclear how this will be achieved.

Changes to VAT accounting on gold
It appears that SARS is losing the battle on combating schemes and malpractices within the gold sector. It was reported in a recent court case that VAT vendors charge VAT on the sale of gold but never pay this to SARS. SARS therefore never collects VAT on the sale but is obliged to allow the recipient an input tax deduction, resulting in a loss in revenue. To combat this, it appears that the purchaser (being a registered vendor for VAT) of gold will be required to account for VAT on the sale of gold on behalf of the seller. This is a new concept in South Africa with regard to local sales and will likely result in significant system changes and practical challenges. It is however an amendment required to protect the fiscus.

Customs & excise

Customs
• Postponement of the export tax on scrap metals, which aimed to replace the current price preference system has been postponed from 1 March 2021 to 1 August 2021.
• Proposed amendment to clarify the regulation and reporting of air cargo for exports at de-grouping depots. Accordingly, the amendment aims to prescribe where de-grouping depots may be established, to which air cargo may be removed from a transit shed before due entry for certain activities.
• For the purposes of the new African Continental Free Trade Agreement (AfCTA) major border posts will be upgraded and expanded.

• Amendments to Tariff Heading 24.03, with the inclusion of Tariff sub-headings 2403.91.11, 2403.91.91 and 2403.99.05 specifically insofar as they apply to “Products intended for inhalation without combustion, put up for retail sale in the form of sticks and/or other”.

Excise

• Sin taxes: an unexpected increase of 8% in 2021/22 for tobacco product excise duties and excise duties on the alcohol industry.

• The current targeted excise duties for wine, beer and spirits are set at 11, 23 and 36 percent respectively.

• An excise duty will be introduced later this year on heated tobacco products. National Treasury will publish a discussion paper on proposals to tax electronic nicotine and non-nicotine delivery systems.

• Progress with the review of the diesel refund administration - in the 2020 Budget Review, National Treasury announced the refinement of the diesel refund notes and rules to the Customs and Excise Act. The second draft was published on 9 February 2021 for public comment.

• In light of the Tariff inclusion of products falling within Tariff Heading 2403.91 of Schedule 1 part 1 of the Customs and Excise Act. The inclusion of Tariff Items 104.35.06, 104.35.10 and 104.35.14 is extended for specific excise duties applicable to “Products intended for inhalation without combustion, put up for retail sale in the form of sticks and/or other”.

• Part 1E of Schedule 6 has further been amended to cater for the inclusion of the additional Tariff Items under Schedule 1 Part 2A.

Fuel Levies

• Inflation related increase of 15c/litre in the general fuel levy and an increase of 11c/litre in the Road Accident Fund levy, with effect from 7 April 2021.

• 1c/litre increase on both petrol and diesel to account for Carbon Tax.
Environmental taxes

Carbon Tax

- The Carbon Tax Rate increased from R127 per t/CO2e to R134 per t/CO2e, from 1 January 2021 as anticipated and aligned with the prescribed increase of CPI + 2%, in terms of Section 5 of the Carbon Tax Act.
- An increase of 1c per litre has been included in the fuel levy price for both petrol and diesel to account for Carbon Tax. The price of petrol will increase by 8c/litre for petrol and 9c/litre for diesel effective from 7 April 2021.
- Department of Environment, Forestry and Fisheries undertaking to review the carbon budget system in an attempt to regulate greenhouse gas emissions by imposing caps on companies for a five-year period.
- Carbon Budget allowance of 5% currently provided for by the Carbon Tax Act will be phased out once the carbon budget system is rolled out, it’s anticipated to be governed by the Climate Change Act.
- Clarification of the renewable energy premium from 1 January 2021, it’s proposed that changes be made to section 6(2)(c) of the Carbon Tax Act to clarify that only entities that conduct electricity generation activities and purchase additional primary renewable energy directly under the Renewable Energy Independent Power Procurement Programme or from private independent power producers with a power purchase agreement are eligible to claim the tax deduction for their renewable energy purchases.
- National Treasury has indicated that only actual forestry plantation sequestered emissions should be eligible for deduction under the Carbon Tax Act.
- Possible inclusion of emission factors resulting from the usage of waste tyres to be included in 2022 Budget Review.

Plastic Bag Levy

- Distinction will be drawn between fossil-based and bio-based plastic bags.
- Fossil-based plastic bags will amount to 25c/bag, whereas bio-based plastic bags will be levied at 12.5c/bag.
- Rationale for inclusion of a bio-based plastic bags levy is such that despite the reduction of greenhouse gas emissions from their manufacture, these products would still contribute towards littering and marine pollution.

VAT: Matthew Besanko, PwC Director
VAT: Rodney Govender, PwC Director
Customs, International Trade and Environmental Taxes: Herman Fourie, PwC Director
Minister of Finance Tito Mboweni delivered his Budget Speech 2021 to Parliament on Wednesday, February 24. This document provides an overview of key information relating to the economic outlook, government revenue and expenditure, fiscal balance, and the public debt trajectory.

**Economic growth forecasts underpinned by a successful vaccine rollout**

Under its baseline scenario, the National Treasury expects the economy to grow by 3.3% this year, and for economic activity to return to pre-pandemic levels by the latter part of 2023. Budget documents have in past been more optimistic about economic growth forecasts compared to those of many economists working in the private sector. However, this time round, the 3.3% figure is below the Bloomberg survey median (3.5%). PwC’s estimate of 3.4% is also lower, thought this is attributed to base effects from our 2020 recession estimate being slightly larger than many other predictions.

Officials are clearly pinning their hopes on a successful roll-out of the COVID-19 vaccine: “A successful vaccine rollout is likely to boost domestic economic growth, enabling renewed trade and releasing pent-up demand. Conversely, a slow, stuttering rollout poses the most significant threat to economic recovery,” commented the Budget Review 2021. The National Treasury’s downside scenario warns of another economic recession should a third and fourth wave of COVID-19 infections hit the country, with the vaccine rollout only gaining traction in 2022.

**Figure 1: Real GDP growth (%)**

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Sources: PwC, National Treasury, South African Reserve Bank (SARB)
Budget Review 2021 also warned of the risks posed by Eskom to the economic outlook. Even in the depths of the 2020 recession, the power utility was unable to guarantee a sufficient supply of power to the country. As the economy recovers, and demand for power grows, Eskom supply will remain under pressure. Despite the ramp-up of its maintenance plan, real improvements in generation reliability are only expected from September this year.

Lifting business and consumer confidence to boost business confidence

Many people looked at the finance minister's speech for inspiration; for some encouragement that 2021 will be a better year. In our report “South Africa’s economic outlook: What can Budget 2021 do to help?” released last week, we identified seven factors that the finance minister could comment on that would support business and consumer confidence. The Budget Review 2021 made the following comments on these points – speaking to three out of the seven factors:

- **Update on structural reforms under Operation Vulindlela** – encouraging updates were provided on speeding up the expansion of electricity generation; employment creation; infrastructure development as well as support for manufacturing, localisation and beneficiation.
- **Cheap working capital loans for start-ups** – no comment.
- **Progress in securing private investment for the state’s Investment Fund** – the pipeline of projects has not yet been approved for public funding, so it does not appear that private money has been committed.
- **Success in allocating 40% of public procurement for women** – no comment.
- **Potential increases in personal income tax rates** – previously announced increases amounting to R40 billion over the next four years have been withdrawn.
- **Suggested basic income grant** – no comment.
- **Extension of R350 Special COVID-19 grant** – no comment.

Revenue collections will be better than previously forecast

The minister cautioned that “an incorrect notion has taken hold that government is swimming in cash”. However, he did admit that the fiscus is in a better place compared to when he delivered the MTBPS 2020 in October. Revenue collections were above expectations during the fourth quarter of 2020, with a particularly strong performance in corporate tax receipts on the back of larger payments from the mining industry.

PwC expected tax income in the current year to be between R100 billion and R108 billion higher than forecast in the Medium-Term Budget Policy Statement (MTBPS): The National Treasury has put the number at R99.6 billion. The better-than-expected tax performance over the past several months, and expectations of this positive outturn continuing in the short term, was anticipated to allow the finance minister leeway to avoid tax rates. MTBPS 2020 suggest that tax increases would be needed to collect an additional R5 billion in the 2021/2022 fiscal year – this amount will now be more than covered by the current outperformance in tax receipts.

On this basis, the finance minister avoided the need to lift income tax rates both now and over the medium term. Minister Mboweni was even able to make good on an earlier pledge to lower company taxes. The corporate tax rate is being reduced by one percentage point to 27% from next year. The step will, however, be revenue neutral, with adjustments to the handling of interest deductions and assessed losses making up for this from a revenue perspective. Further deductions in the corporate tax rate is possible in the future.

Of course, this favourable situation did not change plans for the annual increase in excise duties on tobacco and alcohol products. Both these have seen a steady above-inflation increase in recent years, and 2021/2022 will not be an exception: both will increase by 8.0%. The finance minister commented that excessive alcohol consumption can lead to negative social and health outcomes and that consumers do react to price increases; i.e. higher prices should lead to lower consumption of alcohol products.

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Expenditure: zero-based budgeting starting in 2022/2023

Despite a planned sharp reduction over the medium term in the size of the fiscal budget, Minister Mboweni does not see his budget as one of austerity. In fact, he sees it as growth-stimulating and supportive of the Economic Reconstruction and Recovery Plan on the basis that investment spending will be the fastest growing component of expenditure.

After budgeting R1.9 billion in vaccine spending in the current fiscal year, a total of R9 billion has been set aside over the medium term for the COVID-19 vaccine rollout. This includes R6.5 billion for procurement and distribution of vaccines. Provincial health departments are allocated R2.4 billion to administer the vaccines. PwC believes that some of this funding will come from the general government revenue pool while private medical schemes are also expected to make contributions – likely paying more for their members’ jabs in order to subsidise uninsured individuals.

National Treasury admits that there is great uncertainty over the total cost of the vaccine campaign, and sees room for up to R19.3 billion in spending. Additional funds would come from the contingency reserve and emergency allocations.

Budget 2021 again pledge to implement zero-based budgeting in the near future. This process involves building departmental budgets from scratch instead of just taking the previous year’s numbers and adjusting these for inflation and other needs. In essence, zero-based budgeting requires the justification of all expenditure by doing a full review of spending plans – and not just keeping programs on the go because they were important in the past. The National Treasury and Department of Public Enterprises will be first to pilot a new budgeting methodology with an aim of significantly reducing budgets by 2022/2023.
Good news: a smaller-than-expected fiscal deficit

The projected budget balance for this year and the rest of the medium term is better than economists expected. The current (2020/2021) financial year is expected to see a revenue shortfall equal to 14.0% of GDP compared to an estimate of 15.7% of GDP released in October. For the coming (2021/2022) financial year, the projected shortfall of 9.3% of GDP is also smaller than economists expected, based on a figure of 10.1% of GDP from the Bloomberg survey.

However, while this is good news, a word of caution is important. Budget Review 2021 makes it clear that fiscal consolidation is a priority and that the state will use the better-than-expected revenue situation to reduce the size of the fiscal deficit. However, the aim to reduce the deficit has been in every budget speech over the past decade. And results have been disappointing. South Africa has been unable to perform close to its annual pledges for fiscal consolidation due to a lack of thriftiness as well as over-optimism about revenue prospects.

Figure 2: Budget balance (% of GDP)

On a positive note, the finance minister again pledged to move the primary balance to a surplus by 2024/2025 – only 35% of economists surveyed by Bloomberg ahead of the speech see this as possible. The primary balance represents revenue and expenditure excluding interest payments on consolidated government liabilities.
Public debt

The improvement in deficit projections will have a significant positive impact on the public debt trajectory. Budget Review 2021 is pledging to stabilise public debt at 88.9% of GDP in 2025/2026. This is, as the minister also noted, a significant improvement on the numbers presented in MTBPS 2020. It also brings the current debt trajectory very close to the “active scenario” of deficit and debt management suggested in the Supplementary Budget 2020.

Figure 3: Gross public debt (% of GDP)

Source: National Treasury,