South African Tax Policy: Murky Waters

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Background Considerations

Tax and Politics

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Purpose of Taxation

To Raise Revenue!
-Long-term
-Short-term

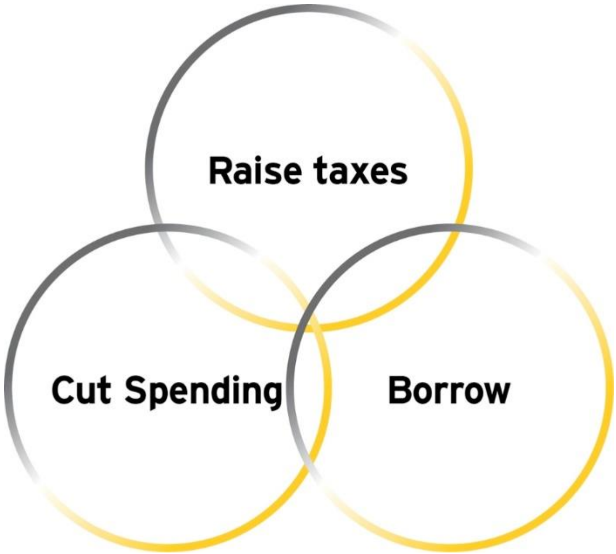
To Redistribute Wealth (“fairness”)
Examples: Income Tax And Estate Duty

To Prevent Economic Distortion “”efficiency”)
Examples: Service income and trading stock income are taxed the same; sole proprietor income are tax the same

To Reduce Externalities and Economic Stimulation
Examples – Reduce externalities: Sin Taxes & the Health Promotion Levy
Example – Stimulate the economy: Employment tax incentives

Basic Macro Funding Choices

The Big 3



Variations

- Generate growth
- Efficiency gains
  - Anti-corruption drives
  - Tax gap closures
  - Government productivity
- One-off actions
  - Asset sales / public-private partnerships
  - Tax amnesties
- Currency devaluation / inflation
- Donor funding
  - Grants, soft loans (BRICs)
  - IMF and Debt bailouts

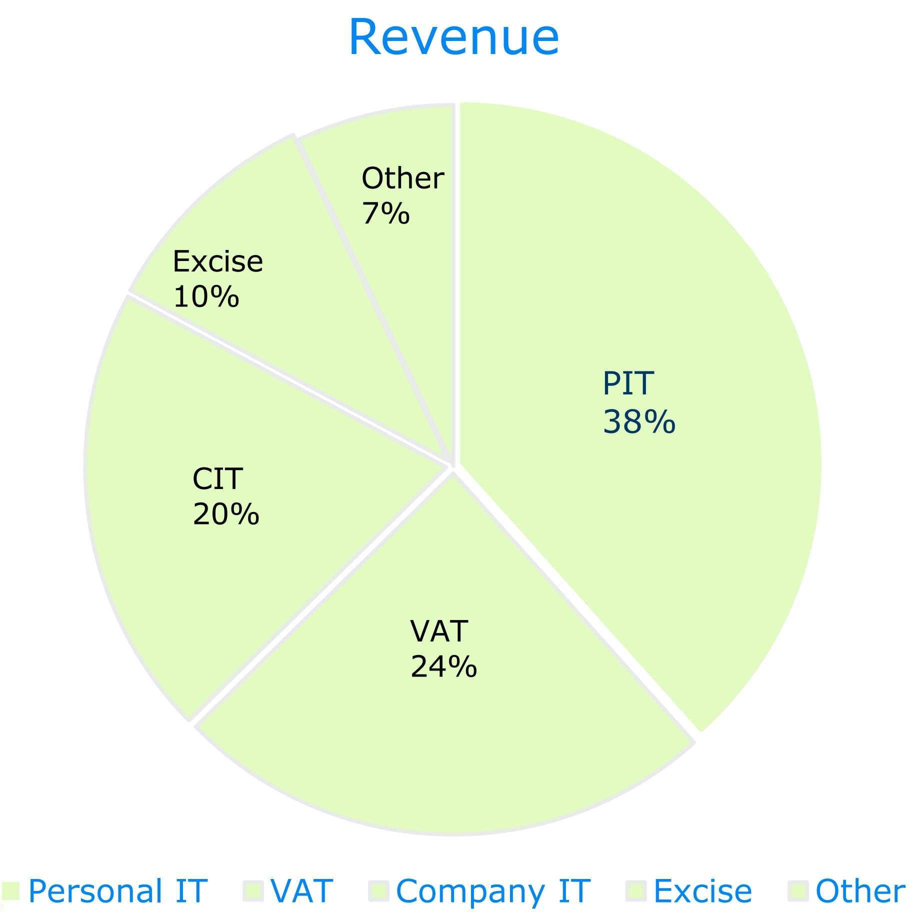
Big Three Taxes

Corporate Income Tax	**Mixed Return [BEPS] (2008+)**	**But Competitive Concerns (2017+)**
Personal Income Tax*	Easiest to Control and Can be Redistributive	Already at Maximum Capacity
Value-Added Tax	Economists Favour and Easy Administrative	Seen as Regressive and Politically Risky to Raise Further

Other Taxes

Fuel Levy (VAT Substitute)	Easy to Increase	Poor Beginning to Notice (also note Toll Roads)
Customs	Still Used as a Revenue Source	Not traditionally favoured and African Customs Union
Sin Taxes (e.g. Alcohol and Cigarettes)	Easy to Raise Politically	Evasion Rife
Environmental Taxes	Politically Correct	Seen as Unfairly Applied and Hits Core Economic Activity
Health Charges	Politically Correct	Questionable Impact and also unpopular

South African Relative Revenue Streams



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National Tax Policy Direction and Trends

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Long-Term Revenue Pressures

- Slow Economy
  - Global economic recovery has bypassed the African economies as quantitative easing was phased-out and internal African political problems have slowed regional growth
  - Primary sector (still SA's main exports)
    - Commodity prices have dropped but somewhat returning
    - South Africa is not viewed as a favourable mining destination given the lack of the post-Apartheid ownership transition
    - Farming flat given the lack of national support (vis-à-vis the northern hemisphere) along with land expropriation
  - Other sectors
    - Manufacturing – small and uncoordinated
    - Financial services have reached their limit
    - Skills shortages despite the large number of unemployed
- Rising local revenue pressures
  - Local discontent (municipal infrastructure)
  - Social demands (e.g. NHI and free fees for universities)
  - Disproportionate public sector employment
  - Political and policy uncertainty continues but slightly improving
  - Need for new infrastructure (NDP) but money lost to corruption
  - Need to revitalise existing infrastructure (e.g. electricity and water) but money again lost to corruption and inefficiencies

Limited Non-Tax Options

- Expenditure Worries
  - High government wage bill
    - 13.8% of GDP
    - 25% of total formal employment
  - Inefficient State-Owned enterprises
  - Pressures
    - Populus (university fees and NHI)
    - Land reform
- Options
  - Reduce corruption (the intention now exists but progress will be slow due to the lack of prosecutions)
  - Reduce inefficiencies and waste (e.g. catering and international trips)
  - Control over salaries (but unions are still asking for wage increases beyond inflation (e.g. 8% SARS increase)
  - SACU payments but political backlash from neighbours
- Debt
  - Holding off junk status (1 out of 3 left)
  - Direct Government and State-Owned Debt guaranteed by Government requiring further bail-outs (especially Eskom)
  - About 4% of GDP
  - Coming out of the credibility gap due to new leadership, but growth below 1% remains a serious problem
  - It is becoming questionable whether government is really committed to controlling national debt (the credit agencies will only wait so long)

Current Tax Policy Paradigm

- Taxpayer mind-set:
  - Tired of Government misuse
  - Active resistance points (e.g. toll roads)
  - Taxpayers feel economically squeezed due to rising costs
  - Wealth being externalized offshore (plus emigration – 900 00+ have left since 2000; about 23 000 per year)
- Options limited
  - Many of the easy loopholes have been closed
  - Heavier taxes can lead to investment flight or reduction in net local economic activity
- Policy reversals
  - Growing use of tax incentives at the behest of other departments to stimulate growth
  - Recent individual income tax rate increase to 45% and lack of fiscal drag in 2019
  - Growing pressure on SARS to raise revenue despite an expected cut-back in employees

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Current Base Broadening Leanings

- Famous BEPS
  - Hints at tightening of the CFC and cross-border debt rules
  - Documentation, MLI and cross-border exchange initiated
  - Tougher OECD interpretations and push toward a new global paradigm (e-commerce debate)
- Wealth Taxes
  - Renewed focus on trusts
  - Davis hostility towards trusts and spousal transfers
- Capital gains
  - Recent increases in capital gains rates
- Indirect
  - VAT stable at 15%
  - Excise / sin taxes
    - New health promotion taxes (e.g. sugar taxes)
    - Environmental charges (and initial implementation of the Carbon Tax)

Growth?: Loving Incentives (Isolated Ones Anyway)

- Items on the table
  - Review of manufacturing and other business incentives
  - Push for employment and training incentives
  - Venture capital
- Has any of these incentives really ever worked?
  - Yes for automobiles
  - Section 12I industrial seems to have a mixed pull
- Continued bureaucratic distrust
  - DTI won't meet with advisors and has no further money for grants (and money is split across multiple miscellaneous incentives)
  - Audit risk that the incentive may be lost due to overly rigid application of the requirements
  - All incentives appear to be overly complicated so the uncertainty means that projects can only view incentives as a bonus (not part of their pricing model)

Growth?: "We Love Small Business"(Again)

- Current regime
  - The turnover tax is often higher than the income tax (especially in loss-making start-up years)
  - The small business company regime mainly applies to high-end professional service firms as a practical matter

- Other things more important:
  - Cash basis of accounting for VAT and Income Tax
  - SARS payment VAT refunds
  - Need for extended time periods to deal with SARS disputes
  - Reasonable penalty and interest regime

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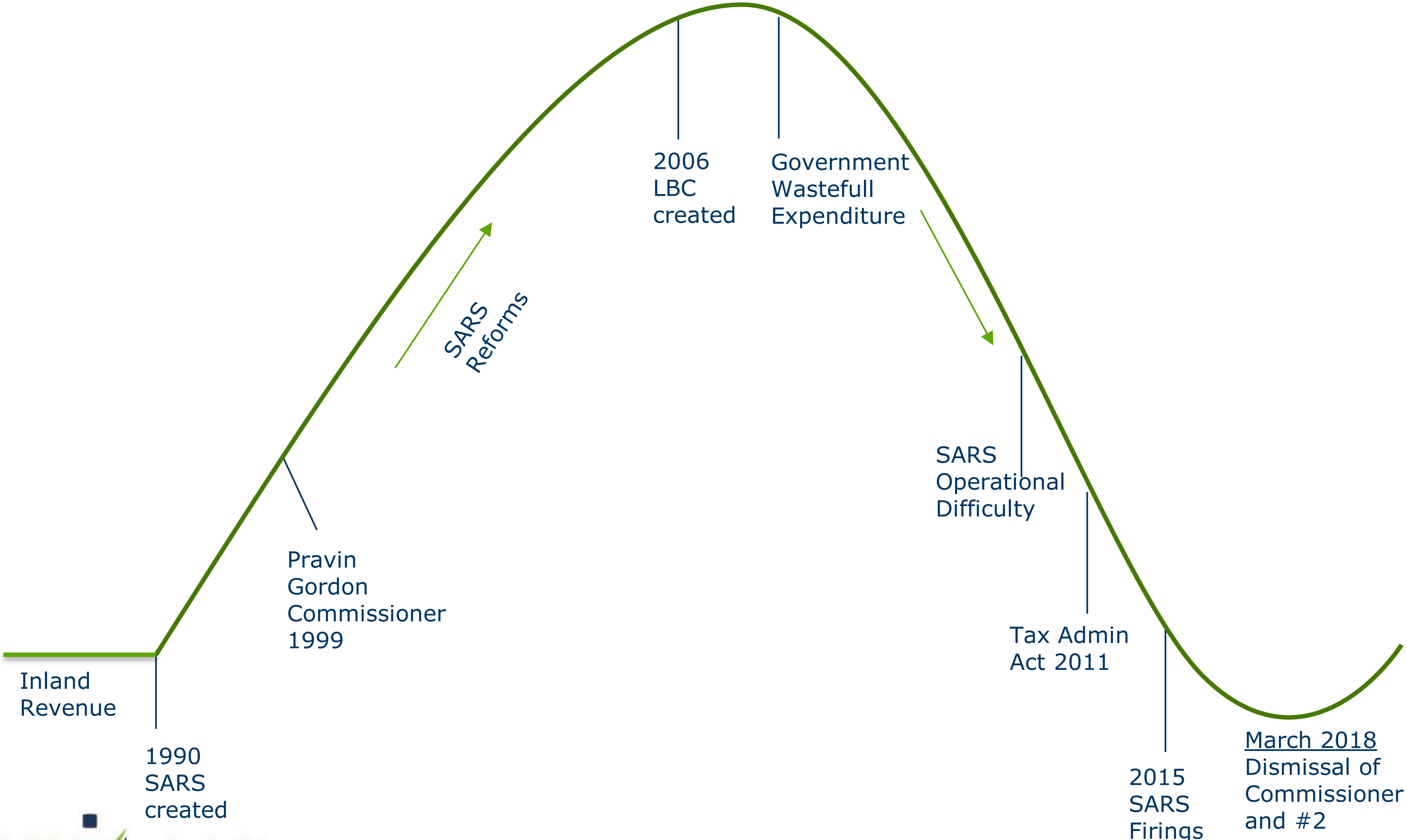
The Rise, Fall and Re-Rise of SARS



Tax Administration Controversy

- History
  - The Tax Administration Act was adopted in 2011 (eliminating fragmented legal administration)
  - Largely seen as an improvement
  - However, taxpayer rights remain a real question and the bill is perceived as often one-sided in favour of SARS
- Lack of balance in tax legislative development (mainly one-sided drafting of laws by SARS with little government questioning)
- New Winds
- Tax Ombud
  - Public media
  - VAT report
  - Entry into limited legal tax administration dialogue
- SARS reputation under repair
  - Some attempts at a "fairer application"
  - Restoring more skilled personnel

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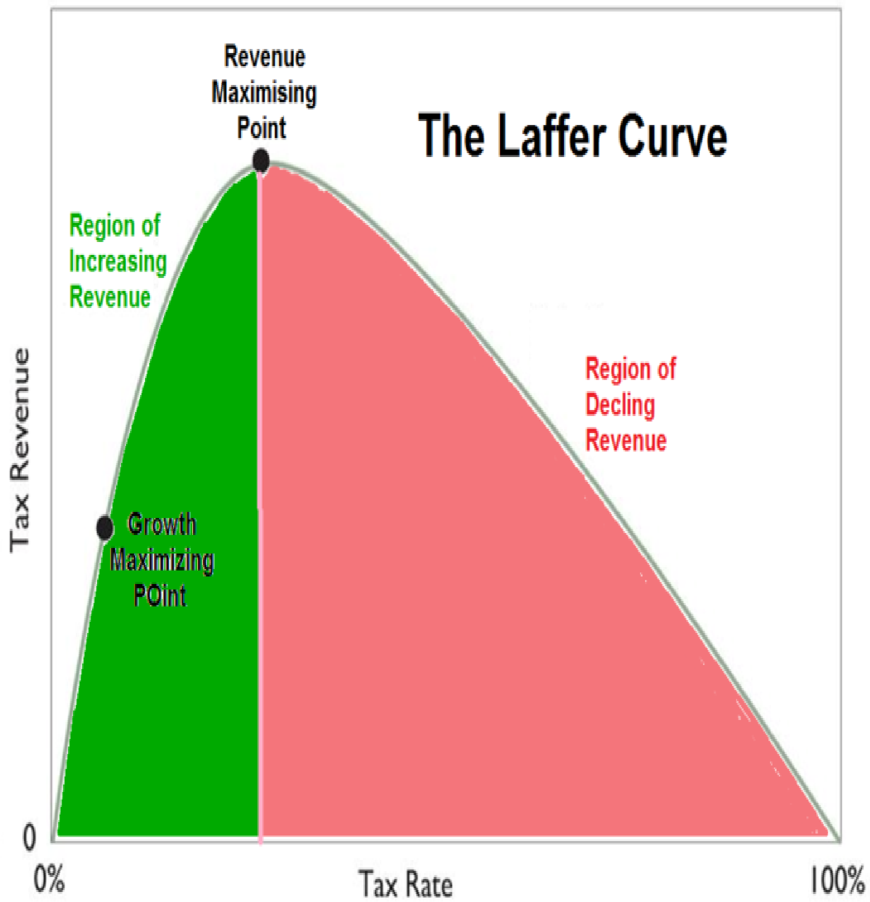
The SARS Challenge

- The formal (mostly honest) segment is tapped out
- Mid-sized businesses going underground
  - Two sets of books and costs mischaracterised
  - Business in trouble using tax money to survive
- Wealth taxes not credible
  - The super-rich continue to move offshore
  - South Africa already distributes more money than any other country in the world



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Taxing the “Cash Economy”

- SARS has never really targeted the cash economy
- Recent effort only comes through broad indirect taxes (e.g. fuel) – painful for the poor
- Targets?
  - ”Tenderpreneurs”?
  - Illegal business (e.g. drugs and cigarettes)?
  - Forensic audits of wealthy lifestyles?
  - Informal sector presumptive taxes (e.g. taxis)?

Impact on Individuals

Possible Daily Impact Going Forward

Will PIT Rates Go Up Further?

- Annual Adjustments
  - National Treasury has seen that taxpayers have reached their limit when rates increased to 45%
  - However, easiest money is not to adjust for fiscal drag (annual inflation)
  - Note that South Africa along with a few other countries have the second highest PIT rates in Africa (Zimbabwe has the highest at over 50% and the solidarity levy)
- NHI
  - The Bill suggests further increases in:
    - Personal income tax rates
    - A new tax on the employer for employees (e.g. an income tax on persons via the employer)
- Social security reform
  - Seems to have died but could result in further increases along the lines of NHI
- Municipal and Provincial incoem tax surcharges?

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Medical

- NHI
  - The NHI will undoubtedly eliminate all medical tax credits
  - However, the disability deduction / credit system may remain but could be curtailed
- Note rising costs of medical aid already from the equalisation fund
- Flight of skilled doctors?

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Indirect Taxes

- VAT and Customs stable
- Fuel levy will continue to rise
- Excise taxes – Expect new charges
- Environmental charges
  - Expect new charges
  - When the Carbon tax ultimately takes effect, expect electricity tax increases

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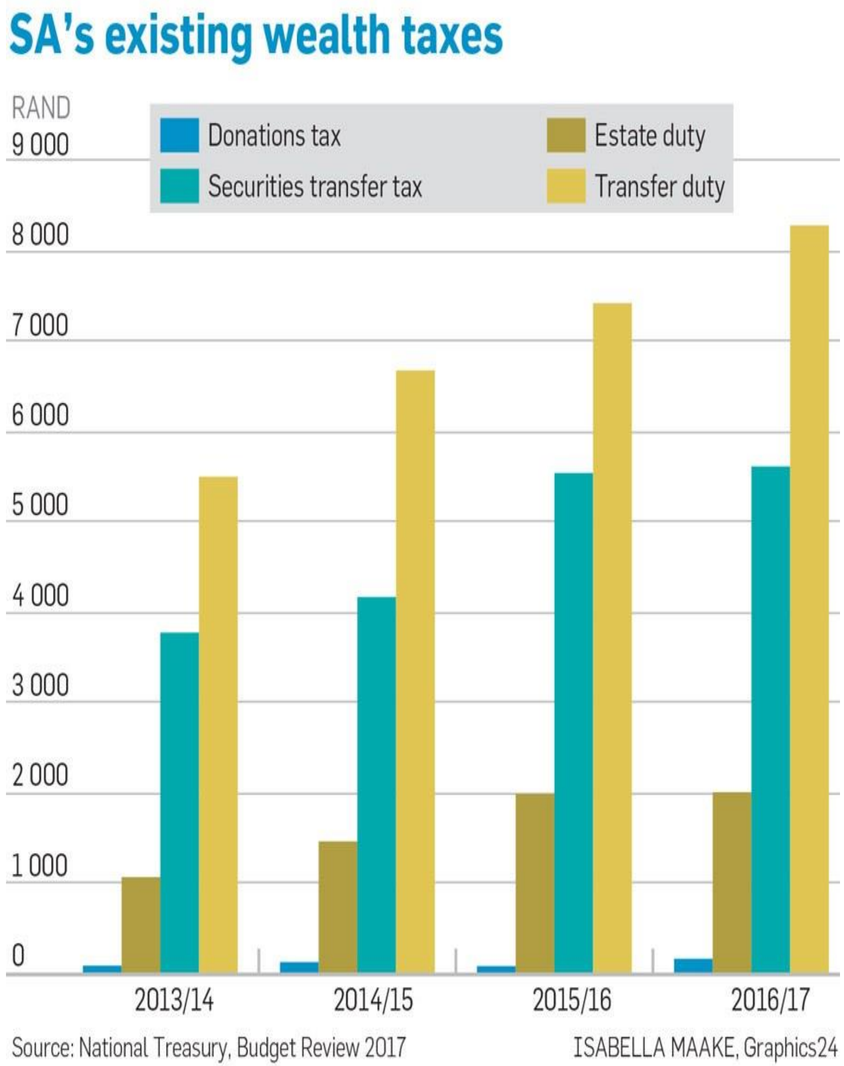
Wealth Taxes



- The Davis Tax Committee to reconvene
  - The current report recommends for but notes the counter-arguments
  - The group may reassert itself (Piketty)
- Potential impact:
  - An annual wealth tax on most assets owned
  - Further increases in Estate Duty
  - Further increases in capital gains tax

Loss of Expatriate Working Abroad Relief

- Narrowing of the work abroad exemption to R1 million (section 10(1)(o))
  - Treasury standing firm
  - Credit problem
  - Hardship payments will be treated as technical fringe benefits
- Many South Africans will shift their tax residence abroad (especially in Dubai and London)

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Expat Charges

- Exit Charge
  - Stable; only a deemed sale event on gains leaving the country
  - Little or no impact on upper middle
    - No effect on pensions
    - No effect on local real estate but the R2 million exemption could be in advertently lost
    - No effect on assets with little appreciation
- Exchange control
  - Remains fairly open with no hostile changes pending
  - SARS final audit can be a challenge
  - No need for financial emigration despite some local advertising to the contrary

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Closing of Further PIT Loopholes?

Legislative

- Car allowance?
- Miscellaneous deductions?
  - Employee business expenses?
  - Home office?
  - Side businesses viewed as hobbies?

Announced SARS Targets

- Rentals
- Unreported commission income (and other side income)
- Unreported capital gains
- Fabricated expenses on employer and employee returns (e.g. excessive deductible donations to charities)

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Mega-SARS Themes

- SARS Third-Party Reporting
  - Rentals and side income
  - Investment income (e.g. banks)
- Tax Evasion
  - Outstanding returns
  - Life style audits for the super rich
  - Criminal activity
- Fabricated refunds
  - Syndicates
  - Both employee and employer returns

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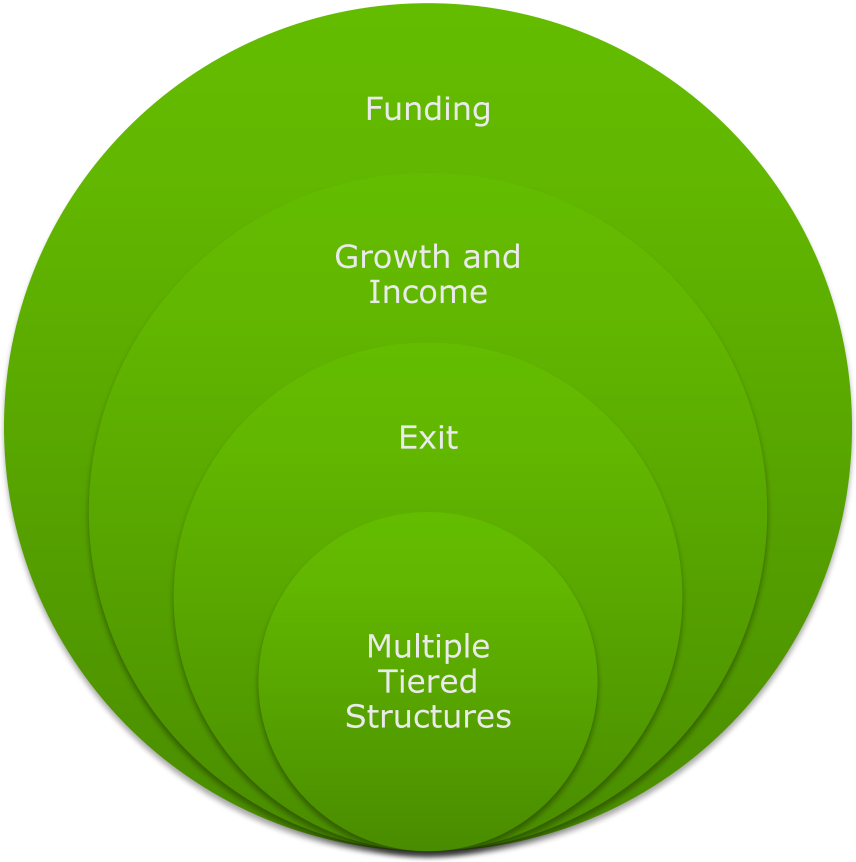
Ongoing Hostility to Trusts

- Domestic
  - High rates and possible targeting of income shifting
  - Funding (section 7C)
  - High charges for exit
- Foreign
  - Dividend repatriations now taxed (e.g. 20%)
  - Seeking an annual tax look-through?
  - Watch-out for transfer pricing risks
  - Exchange control remains on the watch
    - No direct investment in offshore trusts
    - No loops
- Expect more SARS audits
  - No trust returns
  - Questions on trust income allocations



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Taxation of Investments

- Pensions: Current ceiling on deductions to remain
- Bank interest: Ceiling to remain
- Other options
  - Collective investment schemes – investigation of capital versus ordinary distinction
  - Insurance products – stable
  - Special relief low-income savings (growth free) – stable
  - REITs – Stable and possible expansion for unlisted REITs
  - Venture capital – Noise around closing loopholes (current R2.5 million ceiling)
- Overall message [conflicting]
  - Government still seeks to promote investment into savings
  - However, we will tax you heavily if they perceive individuals to be successful

Ongoing Compliance

- New SARS
  - New efiling
  - New efforts at taxpayer service
- Being Watchful
  - Outstanding returns
  - Missing income
- Pressures
  - Penalties and interest
  - Tax administration process