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TaxFocus

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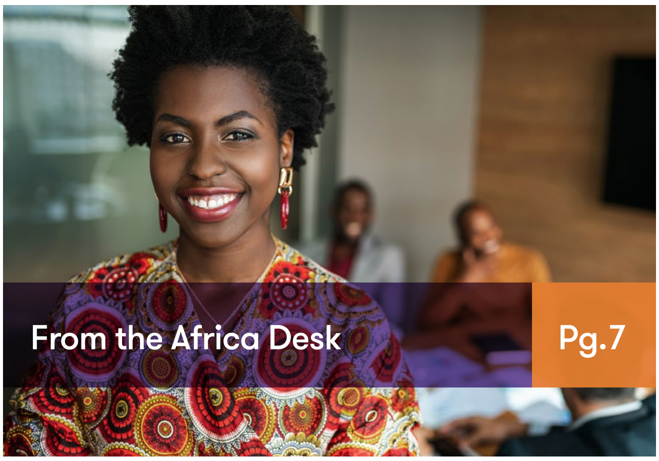
Special Edition: Budget Analysis

Inside this issue



You probably must feel like a dog chasing its own tail, especially those who came back late in the month of January, but hang in there! The routine will become part of you in just a few weeks. Welcome back to all of you.

February represents our first issue for the year.

February is also traditionally the month we get to hear the Finance Minister's Budget Speech. This year's Budget Speech comes at a difficult time for South Africa as we see a gloomy economic outlook and high unemployment. In this issue we look at the key pronouncements from the speech and how these will impact your business and your personal finances.

We look at what is happening from the Africa Desk as Uganda Revenue authority plans to extend Covid-19 tax administrative measures. Also from the Africa Desk, African countries through African Tax Administration Forum (ATAF) are seeking a united front on taxing digital economy. We also take a look at the Uganda economic overview.

We are ready and raring to go!

CLEARR-ly Resilient

2021 Budget analysis and commentary

Building up to every Budget Speech, it is always said by many commentators political as well as economical that, since the global economic meltdown following the financial crisis, the Finance Minister faces a tough decision of striking a balance of the conflicting priorities of the nation. The 2021 budget was no different.

On 24 February, Minister of Finance Tito Mboweni delivered his 2021 Budget Speech amid a difficult climate of COVID-19 pandemic, economic uncertainties, and high level of youth joblessness. The underlying theme of the Budget Speech was about "hope" which has been described as the ability to see that there is light despite all the darkness, a quotation from Nobel Laureate, Archbishop Emeritus Desmond Tutu. We provide here the analysis and the commentary of the some of the major budgetary items:

2020 Projected tax revenue versus projected actual

In the 2020 Budget, the gross tax revenue for 2020/21 was projected to be R1.42 trillion. Due to the impact of the Covid 19, it is now expected that the gross tax revenue will be 10.6 per cent lower than in the previous fiscal year and R213.2 billion lower than projected in the 2020 Budget.

In his supplementary Budget delivered on 24 June 2020, the Minister Mboweni expected to miss the tax revenue target by R300 billion. Fortunately, the short fall is expected to reduce to R213.2 billion as a consequence of the easing of the lockdown which caused a recovery in consumption and wages between October and December 2020. The short fall was further reduced by better than expected collection of provisional tax payments mainly from the mining sector as a result of the sector experiencing favourable foreign exchange rates and high commodity prices.

2021 projected revenue

The main tax revenue for the 2021/22 fiscal year is projected to be R1.35 trillion or 25.3 per cent as a share of Gross Domestic Product (GDP). The attainment of this tax revenue target is based on the assumption that South Africa will achieve the real economic growth of 3.3% for 2021. The ability of the Treasury to correctly project the performance of the economy has a bearing on whether the tax revenue will be collected or not.

Previously, the Treasury's assessment of the economic outlook was not significantly close to the economic realities which were subsequently experienced by the country. For instance, in the 2019 budget Treasury projected that economic growth of 1.5% will be achieved but in reality, growth of 0.3% was achieved.

Some of the key drivers of the country attaining the projected economic growth is the country's ability to vaccinate as many people as possible before winter in order to avoid another possible hard lockdown. Implementation of government's plan to reform the economy in particular, include supply of electricity, access to affordable digital services amongst other areas of priority listed by the National Treasury.

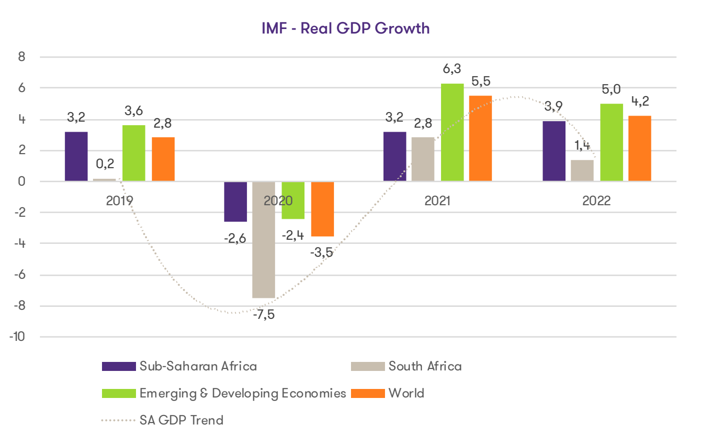
For reasons which are obvious, we have deliberately not done the comparison between what was projected for 2020 and what the actual result was due to the fact that no one would have reasonably assumed the emergence of Covid 19 pandemic.

	2019/20	2020/21
PIT	552,9	546,8
VAT	360,5	360,6
CIT	229,6	230,2
C&E	106,8	112,7
Other	89,5	91,8
Fuel	83	83,4
Rbn	**1422,3**	**1425,5**

	2019/20	2020/21
PIT	38,9%	38,4%
VAT	25,3%	25,3%
CIT	16,1%	16,1%
C&E	7,5%	7,9%
Other	6,3%	6,4%
Fuel	5,8%	5,9%

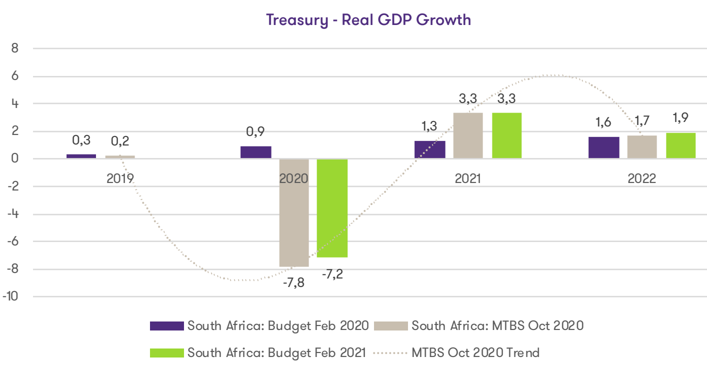
Economic outlook

	Actual	Estimate	Projections	
IMF - Real GDP Growth	**2019**	**2020**	**2021**	**2022**
Sub-Saharan Africa	↑ **3,2**	→ **-2,6**	↑ **3,2**	↑ **3,9**
South Africa	→ 0,2	↓ -7,5	↑ 2,8	→ 1,4
Emerging & Developing Economies	↑ 3,6	→ -2,4	↑ 6,3	↑ 5,0
World	↑ **2,8**	↓ **-3,5**	↑ **5,5**	↑ **4,2**



IMF: The global economy is projected to grow 5.5 percent in 2021 and 4.2 percent in 2022, while South Africa is projected to grow 2.8 percent in 2021, decelerating to 1.4 percent in 2022.

	Actual	Estimate	Projections	
National Treasury - Real GDP Growth	**2019**	**2020**	**2021**	**2022**
South Africa: Budget Feb 2020	↑ 0,3	↑ 0,9	↑ 1,3	↑ 1,6
South Africa: MTBS Oct 2020	↑ 0,2	↓ -7,8	↑ 3,3	↑ 1,7
South Africa: Budget Feb 2021		↓ **-7,2**	↑ **3,3**	↑ **1,9**



Treasury: SA real GDP growth expected to average 2.1% over the medium term & only returning to pre-pandemic levels in 2024.
Risks: i) weaker-than-expected growth, ii) continued deterioration in the public finances, and iii) a failure to implement structural reforms.

Tax statistics

The 2021 Budget Review states that a gradual recovery in revenue is expected over the medium term. The tax-to-GDP ratio now stands at 24.6 per cent. A strong and sustained economic rebound is required for the ratio to return to pre-COVID-19 levels of 26.3 per cent of GDP. According to the 2021 Budget Review, in recent months, faster revenue growth has provided government with the space to support the economy and the health sector, while narrowing the consolidated budget deficit more rapidly than projected in October 2020. The consolidated budget deficit is projected to narrow from 14 per cent of GDP in 2020/21 to 6.3 per cent of GDP in 2023/24.

Gross debt is projected to stabilize at a lower level of 88.9 per cent of GDP in 2025/26. Over the past decade, increased government spending has failed to promote growth. Since 2008, real spending growth has averaged 4.1 per cent annually, well above annual real GDP growth of 1.5 per cent. Yet despite high levels of expenditure, supported by increased debt accumulation, growth has not recovered to pre-2008 levels. Last year, the consolidated fiscal deficit was projected at 15.7 per cent of GDP, up from 6.4 per cent of GDP in 2019/20. Over the medium term, debt-service costs have been the fastest-growing item of spending. Failure to address the deterioration in the fiscal position could lead to a sovereign debt default, which would result in a reversal of many gains of the democratic era.

Main tax proposals

In 2020 Mid Term Budget Policy Statement (MTBPS) delivered on 28 October by Minister Mboweni, it was announced that, to achieve improvement in the revenue collections, the 2021 budget will propose the tax increases. Much to the taxpayers' relief, Treasury has now withdrawn this announcement and no significant tax increases were proposed.

BUSINESS

Corporate Income Tax (CIT)

We welcome the Minister's announcement on the proposal to reduce the corporate tax rate to 27% for companies with years of assessment commencing on or after 1 April 2022. This means that the reduction will effectively be applicable to corporate taxpayer on their 2023 year of assessment. Unfortunately, the Minister warned that the reduction of corporate tax rates comes with the compromise on the implementation of curbing deductibility of interest and application of assessed losses.

Limitation of interest deductions

In order to combat the base erosion and profit shifting (BEPS) by multinational corporations, Government in its 2020 budget proposed to restrict net interest expense deductions to 30 per cent of earnings for years of assessment commencing on or after 1 January 2021.

Shortly after the 2020 Budget, a discussion paper on Reviewing the Tax Treatment of Excessive Debt Financing, Interest Deductions and Other Financial Payments was issued for public comment. After assessing the public comments and consultations, government proposes to expand the scope of the current interest limitation rules to include some similar interest items, to adjust the fixed-ratio limitation for net interest expense to 30 per cent of earnings; and to restrict only interest incurred on connected party instruments.

As part of the COVID-19 tax relief measures, this proposal was postposed to 01 January 2022.

Limitations on the utilization of assessed losses
An assessed loss is created when the company's tax-deductible expenses exceed its income. The assessed loss is carried forward to the following year and is utilized to offset against taxable income in that year. In the 2020 Budget, Government proposed broadening of the corporate income tax base by restricting the offset of assessed losses carried forward to 80 per cent of taxable income, for years of assessment commencing on or after 1 January 2021. As part of the COVID-19 tax relief measures, this proposal was postposed to 01 January 2022. It will be interesting to see how cash management and financial statements of state-owned entities with large assessed losses will be impacted by this proposed change if implemented in coming years.

Sunset dates for corporate tax incentives
In the 2021 Budget, the Government proposes the following sunset dates for corporate tax incentives:

Incentives			
#	Section of the Income Tax Act	Nature of incentive	Sunset date
A	Section 12J	The venture capital company incentive	30-Jun-21
B	Section 12F	Airport and port assets incentive	28-Feb-22
C	Section 12DA	Rolling stock incentive	28-Feb-22
D	Section 13Sept	loan for Low-cost residential units incentive	28-Feb-22
E	Section 120	Exemptions fo film incentive	1-Jan-22

With regard to B, C, D, E incentives, stakeholders are invited to motivate why these incentives should not be allowed to lapse on reaching their respective sunset dates. These motivations should be submitted to the National Treasury by 31 March 2021.

Capital Gain Tax (CGT)
CGT is triggered by a disposal or deemed disposal of an asset. Following the reduction of the CIT rate, the effective rate of CGT will decrease from 22.4% to 21.6%.

International Tax

Controlled Foreign Companies

Clarifying the controlled foreign company diversionary rules
In 2011, the diversionary rules governing the outbound sale of goods by a controlled foreign company (CFC) were abolished because the transfer pricing rules could be applied instead. In 2016, government reinstated the diversionary rules for CFC outbound sale of goods due to their effectiveness in preventing base erosion and profit shifting.

The 2016 diversionary rules for CFC outbound sale of goods now provide for an exemption if similar goods are purchased by the CFC, from unconnected persons to that CFC, mainly within the country in which the CFC is resident. Certain taxpayers are circumventing these rules by merely entering into a contract of purchase and sale that implies that the purchase of goods took place in the country of residence of the CFC, when this is not the case. To curb this abuse, it is proposed that these diversionary rules be amended.

Clarifying the interaction between provisions dealing with a CFC ceasing to be a CFC and the participation exemption.
In 2020, changes were made to the Income Tax Act to reduce tax planning opportunities that may emerge from loop structures as a result of the relaxation of the approval requirement by the Reserve Bank. An amendment was made in relation to gains on the disposal of shares in a non-resident company to a non-resident that was not taxed because of the participation exemption in paragraph 64B of the eighth schedule.

This amendment has the effect that the participation exemption does not apply to the disposal of shares in a CFC to the extent that the value of the CFC's assets is derived from South African assets. However, section 9H provides that where a CFC ceases to be a CFC as a direct or indirect result of the disposal of all or some of the equity shares in that CFC, the capital gain or loss realised in respect of such disposal is disregarded if the participation exemption under paragraph 64B of the eighth schedule applies. To address the interaction between section 9H and paragraph 64B, it is proposed that section 9H be amended so that a partial participation exemption in terms of paragraph 64B(6) of the eighth schedule would not affect the exclusion under section 9H(5).

Clarifying the rules dealing with withholding tax exemption declaration

The act contains provisions in part IV A and part IV B for withholding tax on royalties and interest respectively. According to the rules dealing with withholding tax on interest, no withholding tax on interest applies if the foreign person submits a declaration that he/she is – in terms of an agreement for the avoidance of double taxation – exempt from the tax. A similar declaration does not exist for withholding tax on royalties. To address the anomaly, it is proposed that the tax legislation be amended.

Base erosion, profit shifting (BEPS) and digital services taxation

For any tax system to be effective, it needs to take into account the globalised nature of trade, investment and technological change. South Africa is party to many multinational tax processes and agreements, including international negotiations to finalise a treaty on base erosion and profit shifting. This initiative aims to reduce tax avoidance by multinational companies, and ensure that national tax bases are not eroded. As of January 2021, 92 countries, including 13 African states, had signed the relevant agreement. South Africa has signed but not ratified its participation, which requires parliamentary approval. In addition, government proposes to renegotiate some existing bilateral tax treaties with those countries that are not signatories to the agreement.

South Africa is a member of the Steering Group of the Inclusive Framework, which is examining income tax challenges associated with digitalisation of the economy. In June 2019, the Group of 20 endorsed a work programme with the commitment to deliver a consensus-based solution by the end of 2020. However, the pandemic has delayed this process. Work continues towards developing a consensus by mid-2021. Should these efforts fail, South Africa will consider the appropriateness of a unilateral approach.

Value Added Tax

VAT is levied at the standard rate of 15% on the supply of goods and services by registered vendors. No changes were proposed.

Dividends Tax

Dividends tax is a final tax on dividends at a rate of 20%. No changes were proposed.

Individual

The personal income tax brackets will be increased by 5 per cent, which is more than inflation. This will provide R2.2 billion in tax relief. Most of that relief will reduce the tax burden on the lower and middle-income households.

Tax rates from 1 March 2021 to 28 February 2022: Individuals and special trusts

Taxable Income (R)	Rate of Tax (R)
1 – 216 200	18% of taxable income
216 201 – 337 800	38 916 + 26% of taxable income above 216 200
337 801 – 467 500	70 532 + 31% of taxable income above 337 800
467 501 – 613 600	110 739 + 36% of taxable income above 467 500
613 601 – 782 200	163 335 + 39% of taxable income above 613 600
782 201 – 1 656 600	229 089 + 41% of taxable income above 782 200
1 656 601 and above	587 593 + 45% of taxable income above 1 656 600

Rebates	
Primary	R15 714
Secondary	R8 613
Tertiary	R2 871

Tax threshold	
Below age 65	R87 300
Age 65 and over	R135 150
Age 75 and over	R151 100

2021 Budget Review - International Tax

Tax Statistics

2021 tax-to-GDP ratio

The tax-to-GDP ratio, which gives a sense of the tax burden, shows tax revenue as a percentage of gross domestic product (GDP). The higher the percentage, the higher the amount of tax collected relative to the size of the economy.
How does South Africa compare with other countries in terms of the tax-to-GDP ratio? Data is available from both the International Monetary Fund (IMF) and the Organisation for Economic Co-operation and Development (OECD).

Is having a high tax-to-GDP ratio a good or a bad thing? It depends on each country. For a nation that has a high ratio but where taxpayers are receiving good value for money, a high tax burden might not be that detrimental. Countries such as Denmark, Sweden and Finland have high tax-to-GDP ratios, but these nations report the highest standard of living.

A very low tax-to-GDP ratio can be problematic as it may be a sign of an inefficient tax system. A government will struggle to provide services, build infrastructure or maintain public goods if it fails to collect taxes during periods of strong economic growth. Indonesia, for example, has in recent years committed itself to raise its tax-to-GDP ratio from 10% to 15%.

The tax-to-GDP ratio alone provides no indication of good governance, the efficiency of the taxation system in the country, nor the way in which taxes are used or distributed.

Within the 2020 Budget Review, it was stated that substantial tax increases were unlikely to be effective. South Africa already had a relatively high tax-to-GDP ratio compared with other countries at a similar level of development. New tax increases at that time could have harmed the economy's ability to recover and this remains the position currently.

In the 2020 budget review, the projected tax-to-GDP ratio was expected to equal 26.3 per cent over the next three years. South Africa had a relatively high level of tax to GDP compared with other upper middle-income countries. Higher levels of economic growth were required for further tax increases to be effective in consolidating the public finances or financing additional expenditure.

The 2021 Budget Review states that a gradual recovery in revenue is expected over the medium term. The tax-to-GDP ratio now stands at 24.6 per cent. A strong and sustained economic rebound is required for this ratio to return to pre-COVID-19 levels of 26.3 per cent of GDP.

2021 debt-to-GDP ratio

According to the 2020 Supplementary Budget Review, gross national government debt was projected to increase from R3.26 trillion (63.5 per cent of GDP) in 2019/20 to R3.97 trillion (81.8 per cent of GDP) in 2020/21. By the end of 2022/23, gross loan debt was expected to amount to R4.83 trillion, or 86 per cent of GDP.

According to the 2021 Budget Review, in recent months, faster revenue growth has provided government with the space to support the economy and the health sector, while narrowing the consolidated budget deficit more rapidly than projected in October 2020. The consolidated budget deficit is projected to narrow from 14 per cent of GDP in 2020/21 to 6.3 per cent of GDP in 2023/24. Gross debt is projected to stabilise at a lower level of 88.9 per cent of GDP in 2025/26.

Impact of Covid 19

Over the past decade, increased government spending has failed to promote growth. Since 2008, real spending growth has averaged 4.1 per cent annually, well above annual real GDP growth of 1.5 per cent. Yet despite high levels of expenditure, supported by increased debt accumulation, growth has not recovered to pre-2008 levels.

Last year, the consolidated fiscal deficit was projected at 15.7 per cent of GDP, up from 6.4 per cent of GDP in 2019/20. The debt stock was expected to reach nearly R4 trillion, or 81.8 per cent of GDP, in 2020/21. Over the medium term, debt-service costs have been the fastest-growing item of spending. Failure to address the deterioration in the fiscal position could lead to a sovereign debt default, which would result in a reversal of many gains of the democratic era.

As per the 2021 Budget Review, the COVID-19 pandemic has had a severe impact on tax revenue collection. Given large predicted shortfalls in revenue for 2020/21 and over the next three years, the 2020 Medium Term Budget Policy Statement (MTBPS) confirmed that tax increases totalling R40 billion would be required over the next four years to help stabilise public debt and return the public finances to a sustainable position. These increases were first announced in the June 2020 special adjustments budget.

Gross tax revenue for 2020/21 is now expected to be 10.6 per cent lower than in the previous fiscal year and R213.2 billion lower than projected in the 2020 budget due to the pandemic. However, as a result of the recovery in consumption and wages between October and December 2020, and a boost to corporate income tax receipts from the mining sector, 2020/21 revenue collections are expected to be R99.6 billion above the 2020 MTBPS estimate.

From the Africa Desk

Uganda Revenue Authority (URA) plans to extend Covid-19 tax administrative measures

Uganda Revenue Authority (URA) has said that it will extend most of the administrative measures created in light of covid-19 pandemic to encourage tax compliance from the public. According to the Commissioner General of URA, the measures have proved important and useful to both the tax payers and authority. URA unveiled the measures at the beginning of this financial year with the aim of boosting compliance amongst taxpayers. However, the measures such as voluntary disclosure had deadlines.

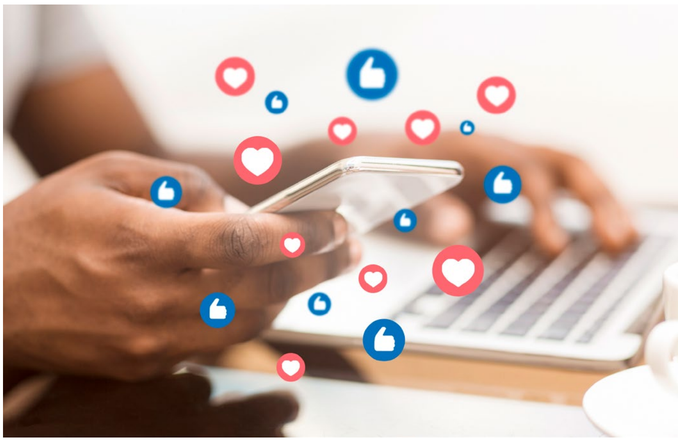
Voluntary disclosure program is a tax compliance enhancing measure introduced by URA during the 2020/21 financial year. The programme pardons tax payers from interest or fines once they voluntarily disclose taxes that ought to have been paid earlier on but were not disclosed or were partially disclosed. It is pertinent to note that the Voluntary disclosure only applies only to those taxpayer who have not been prompted by URA through tax investigations, audits or visits. In addition, CG also said that the laws that were passed to provide relief to businesses such as deferred payments on Value Added Tax, Corporation and Withholding Tax will be sustained until the next financial year subject to review by Ministry of Finance.

Africa seeking united front on taxing digital economy

URA was this financial year given a steep target of Ush 21.8 trillion which was later revised downwards to Ush 19 trillion due to the anticipated effects of Covid-19. However, URA has since registered surpluses in tax collection to which the commissioner general said was partly as a result of lowered targets. The Authority said it would employ technology in its endeavours to plug tax leakages such as identifying potential tax payers in the real estate sector, the electronic fiscal receipting and invoicing solution and digital tax stamps among others.

African countries, through African Tax Administration Forum (ATAF) are seeking ways as a bloc through which they can tax the digital economy, which continues to present difficulties for tax authorities across the continent. Big tech giants such as Google and Facebook, among others, rack up huge amounts of revenue from low income earning economies but do not contribute much to the growth of such economies.

There is an ongoing conversation at regional and continental level on how to move in on the digital economy without suffocating businesses hosted on such platforms.



“Big tech giants such as Google and Facebook, among others, rack up huge amounts of revenue from low income earning economies but do not contribute much to the growth of such economies.”

Ugandan government imposed a Ush 200 levy on social media access, introducing a tax - over the top tax (OTT) in May 2018, which remains highly controversial. This tax is levied in the nature of digital service tax to prevent “gossip” and broaden the country’s tax base. In Tanzania, to curb hate speech and fake news, the government introduced the Electronic and Postal Communications Regulations, 2018, for bloggers, online radio and television requiring them to pay an annual fee of $900. Kenya has also recently joined Uganda and Tanzania in taxing digital services, primarily to support its depleted public coffers in an economy weighed down by slowing private sector activities, shrinking revenue collections, growing public debt and increasing expenditure pressures.

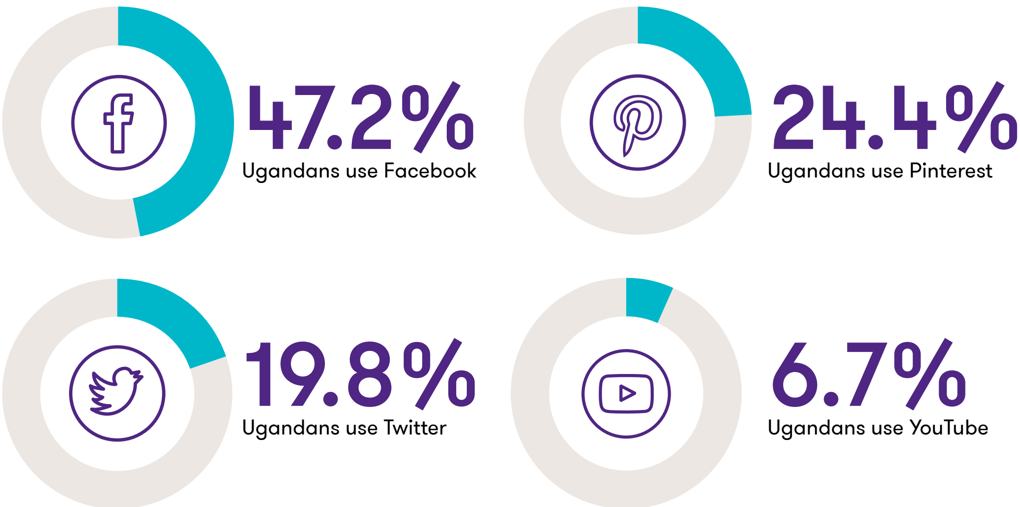
The new tax has imposed at 1.5% of gross income derived from all services offered through the digital marketplace including downloadable content such as mobile apps, e-books and films, and over-the-top services that include streaming television shows, films, music, podcasts and any other digital content.

ATAF believes they can build capacity under an alliance to plan a better and more efficient way of taxing tech giants, some of which command huge budgets that are bigger than most African countries.

However, ATAF notes that lack of political will from African elite, leadership and the overshadowing of African views by other countries of the Organisation for Economic Cooperation and Development, present some challenges.

The digital economy has grown at a supersonic speed with the emergence of Covid-19, which forced businesses to shift to digital operations, which came with a lot of innovations.

It is worth noting here that at least:



Video streaming platform, Netflix which earns money from video content, is also budding in Uganda. Whereas Uganda remains an insignificant market for major tech giants, Statisca puts video streaming penetration in Africa at 10.5% in 2020 and is expected to hit 14.2% by 2024 with revenue in the Video Streaming segment amounting to $1.1b in 2020.

Only time will tell what Uganda's future holds for the digital economy.

Click here to download the below pdf on Uganda Economic Outlook/Overview 2020/21!

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