Sec finance 27/11/18

2018 BUDGET PROPOSALS AND DRAFT RATES AND MONETARY AMOUNTS AND AMENDMENT OF REVENUE LAWS BILL

Select Committee on Finance

Presenters: National Treasury | 27 November 2018

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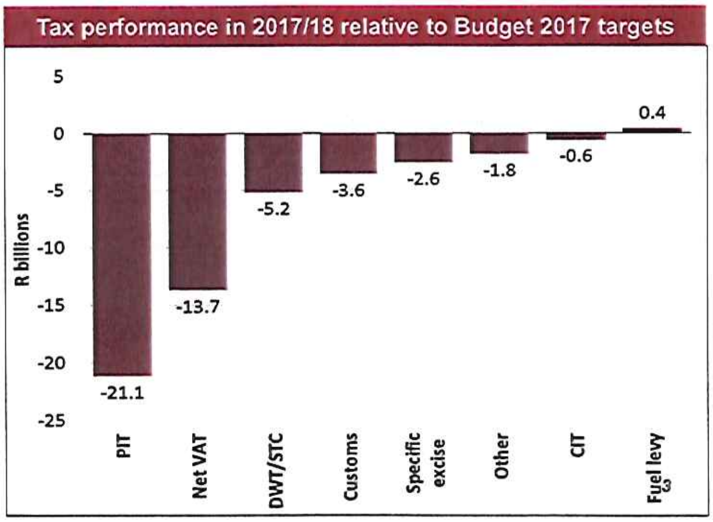
2018 Budget tax proposals

- The 2018 BUDGET contains significant tax proposals given funding shortfalls
  - Estimated R48.2bn shortfall for 2017/18 compared to 2017 Budget
  - Tax proposals in 2018 Budget aimed to raise R36 billion in tax revenues

- Chapter 4 of Budget Review deals with most significant tax proposals, and Annexure C deals with other tax proposals, including anti-avoidance measures
- Annexure B deals with tax expenditures which is revenue foregone through incentives
- Rates Bill published on Budget Day deals with key rate monetary threshold changes, and more complex tax proposals will be dealt with in TLAB and TALAB Bills to be published in July for public comment
- Separate process is continuing for other measures, such as the Carbon Tax Bill
- All the above are first draft bills, and tabled only after public hearings

Expected tax revenue shortfall of R48.2 billion for 2017/18

- Gross tax revenue for 2017/18 R48.2 billion lower than the 2017 Budget estimate
- Personal income taxes, net VAT, and dividend withholding tax are all expected to show large shortfalls, with smaller shortfalls forecast for customs duties and specific excise duties
- The net fuel levy is expected to marginally outperform projections due to slowing diesel refunds
- Revenue collection has improved since the 2017 MTBPS in line with stronger economic performance
- Risks include weaker-than-expected economic growth, and concerns about tax morality, compliance and administration.
- Unaudited outcome down by R48.9 billion



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Tax proposals aim to raise R36 billion

Tax proposals expected to generate R36 billion in tax revenue for 2018/19

This will go a long way to reduce the budget deficit and help pay for social programmes, such as fee-free higher education for poor & working class students

The main tax proposals include the following:

- One percentage point increase in VAT from 14 to 15 per cent
- Limited relief for bracket creep for the bottom three personal income tax brackets, no relief for the top four brackets
- Increase in the ad-valorem excise duty rate on luxury goods from 7 to 9 per cent and increase in ad valorem cap on luxury motor vehicles from 25 to 30 per cent
- Higher estate duty tax rate of 25 per cent for estates greater than R30 million
- 22c/l for the general fuel levy
- 30c/l for the RAF levy
- Increases in excise duties on alcoholic beverages and tobacco products between 6 and 10 per cent

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Main revenue item is the VAT increase

Table 4.3 Impact of tax proposals on 2018/19 revenue[1]

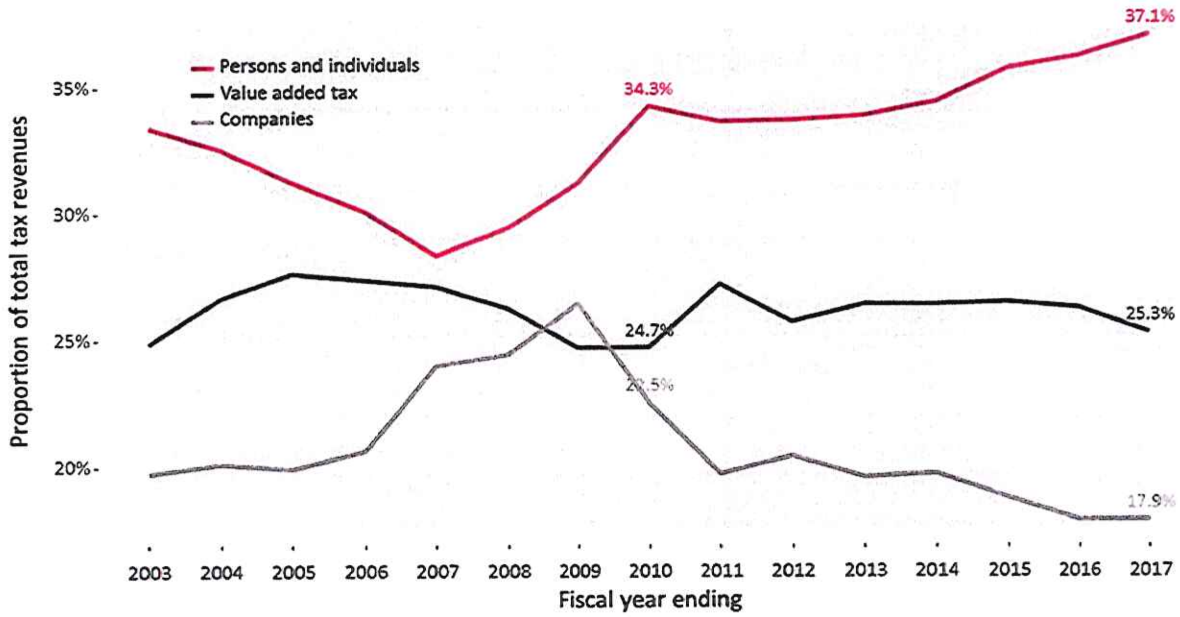
R million		
Gross tax revenue (before tax proposals)		1 308 965
Budget 2018/19 proposals		**36 000**
Direct taxes		7 310
Taxes on individuals and companies		
Personal income tax	7 510	
Revenue from not fully adjusting for inflation	6 810	
Revenue if no adjustment is made	*14 155*	
Partial bracket creep for personal income tax	*-7 345*	
Medical tax credit adjustment	700	
Corporate income tax	-350	
Special economic zones	-350	
Taxes on property	150	
Estate duty increase	150	
Indirect taxes		28 690
Increase in value-added tax	22 900	
Increase in general fuel levy	1 220	
Increase in excise duties on tobacco products	420	
Increase in excise duties on alcoholic beverages	910	
Increase in ad valorem excise duties	1 030	
Increase in environmental taxes	280	
Introduction of health promotion levy	1 930	
Gross tax revenue (after tax proposals)		1 344 965

Second largest increase is from personal income taxes

Draft Rates and Monetary Amounts and Amendment of Revenue Laws Bill, 2018 (Rates Bill)

- The Draft Rates Bill gives effect to the tax proposals dealing with tax rates and monetary threshold announced in the Budget. These proposals relate to:
  - Income Tax
  - Transfer Duty
  - VAT
  - Customs Duties
  - Excise Duties
- It enacts proposals that take effect on the Budget Day (e.g., 21 February 2018), or on 1 March or 1 April of every year or on the date of promulgation of the Rates Bill
- The items in the Rates Bill consist of the revenue items shown in the previous slide
- NT published the Rates Bill for comment on Budget day, prior to formal introduction in Parliament.
- NT and SARS introduced the Rates Bill informally to SCoF
- The Rates Bill was tabled by the Minister formally in Parliament for consideration during Medium Term Budget Policy Statement on 24 October 2018

Revenues increasingly reliant on personal income taxes



Personal income taxes have been increased substantially over the past four years

- 1 percentage point increase in 2014/15 across all the brackets
- 4 percentage point increase in the top bracket, from 41 per cent to 45 per cent, for 2016/17
- Minimal relief for bracket creep in 2013/14 (3.5 per cent), 2016/17 (1.8 per cent) and 2017/18 (1 per cent)

Compared to a scenario where the personal income tax tables had been increased by inflation over the past five years,

- an individual earning R350 000 now pays an extra R6 200 per annum in tax
- while an individual earning R2 million pays an extra R50 000 in tax in real terms

Progressive changes to the personal income tax system in recent years include

- moving from a medical tax deduction to a medical tax credit
- limiting the deduction available for retirement fund contributions
- increasing the effective capital gains tax rate from 10 per cent to 18 per cent

The scope for substantial revenues from the top are limited

- The current estimate is that PIT revenues will fall short by R21.1 billion, contributing over 40 per cent of the total expected shortfall of R48.2 billion at the time of the Budget
- Given the relatively small income tax base at the top end of the distribution, increases in the top marginal tax rate are not expected to yield significant revenues
  - The increase from 41 per cent to 45 per cent this year was expected to generate an additional R4.4 billion, however this is looking unlikely to be realised as PIT revenues are the biggest underperforming tax category this year
  - Increasing the top rate to 50 per cent may bring in around R5 billion, but behavioural effect is difficult to judge and could lead to a lot less (which is what appears to have happened last year)
- With much higher rates individuals may increase avoidance or evasion, through the use of greater deductions or structuring or through evasion
- Real impact on work effort and economic activity as additional returns are diminished

But 2018 Budget proposes increases of R6.9 billion in PIT

- Budget 2018 raised PIT revenue by not providing full relief for inflation
- But greater amount of relief was given for those on lower incomes
- 3.1 % increase in thresholds for bottom four brackets and rebates
- No increase for those in upper brackets

Table 4.5 Personal income tax rates and bracket adjustments

2017/18		2018/19	
Taxable income (R)	**Rates of tax**	**Taxable income (R)**	**Rates of tax**
R0 - R189 880	18% of each R1	R0 - R195 850	18% of each R1
R189 881 - R296 540	R34 178 + 26% of the amount above R189 880	R195 851 - R305 850	R35 253 + 26% of the amount above R195 850
R296 541 - R410 460	R61 910 + 31% of the amount above R296 540	R305 851 - R423 300	R63 853 + 31% of the amount above R305 850
R410 461 - R555 600	R97 225 + 36% of the amount above R410 460	R423 301 - R555 600	R100 263 + 36% of the amount above R423 300
R555 601 - R708 310	R149 475 + 39% of the amount above R555 600	R555 601 - R708 310	R147 891 + 39% of the amount above R555 600
R708 311 - R1 500 000	R209 032 + 41% of the amount above R708 310	R708 311 - R1 500 000	R207 448 + 41% of the amount above R708 310
R1 500 001 and above	R533 625 + 45% of the amount above R1 500 000	R1 500 001 and above	R532 041 + 45% of the amount above R1 500 000
Rebates		**Rebates**	
Primary	R13 635	Primary	R14 067
Secondary	R7 479	Secondary	R7 713
Tertiary	R2 493	Tertiary	R2 574
Tax threshold		**Tax threshold**	
Below age 65	R75 750	Below age 65	R78 150
Age 65 and over	R117 300	Age 65 and over	R121 000
Age 75 and over	R131 150	Age 75 and over	R135 300

Source: National Treasury

Medical tax credits increase is below inflation to partially fund NHI

- Medical tax credits increased to R310 per month for first two beneficiaries (from R303) and to R209 for additional beneficiaries (from R204)
- This below inflation increase of 2.3% will raise R0.7bn and fund the initial expansion of NHI
- Commitment to further below inflation increases in next two years for additional NHI funding

Table 4.6 Estimates of individual taxpayers and taxable income, 2018/19

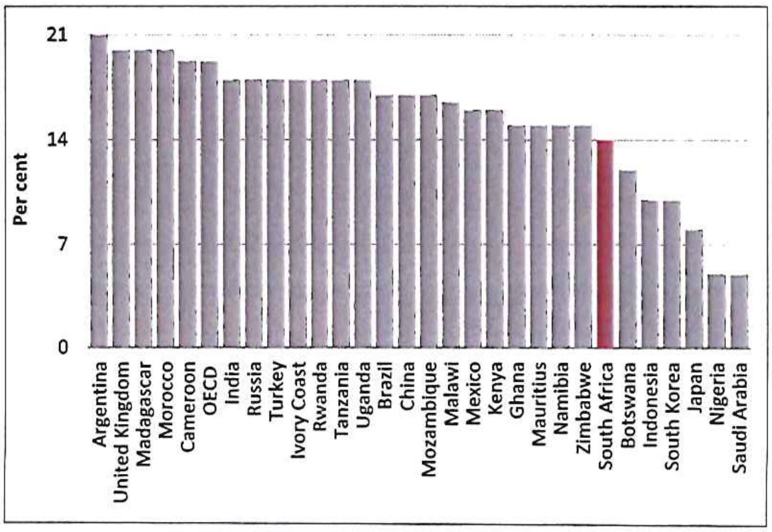
Taxable bracket	Registered individuals		Taxable income		Income tax payable before relief		Income tax relief		Income tax from medical tax credits		Income tax payable after proposals	
R thousand	Number	%	R billion	%	R billion	%	R billion	%	R billion	%	R billion	%
R0 - R70[1]	6 557 245	–	170.2	–	–	–	–	–	–	–	–	–
R70 - R150	2 502 678	33.4	262.0	10.8	11.1	2.2	-0.9	12.5	0.04	5.0	10.2	2.0
R150 - R250	1 790 280	23.9	351.8	14.5	34.3	6.7	-1.3	17.3	0.16	23.1	33.2	6.6
R250 - R350	1 178 901	15.7	349.8	14.4	51.6	10.1	-1.3	18.4	0.15	22.1	50.5	10.0
R350 - R500	934 615	12.5	386.8	15.9	74.2	14.5	-1.6	21.5	0.15	21.9	72.7	14.4
R500 - R750	576 469	7.7	348.4	14.3	85.6	16.7	-1.2	16.1	0.10	14.3	84.5	16.7
R750 - R1 000	233 652	3.1	200.7	8.3	58.4	11.4	-0.5	6.5	0.04	6.1	58.0	11.5
R1 000 - R1 500	161 014	2.2	192.3	7.9	62.4	12.2	-0.3	4.5	0.03	4.4	62.1	12.3
R1 500 +	109 783	1.5	339.4	14.0	134.8	26.3	-0.2	3.1	0.02	3.2	134.6	26.6
Total	7 487 392	100.0	2 431	100.0	512.5	100.0	-7.3	100.0	0.70	100.0	505.8	100.0
Grand total	14 044 637		2 601		512.5		-7.3		0.70		505.8	

1. Registered individuals with taxable income below the income-tax threshold

VAT will have the least harmful impact on growth

- VAT is an efficient, certain source of revenue provided that its design is kept simple
- Increasing the VAT rate by one percentage point is estimated to have the least detrimental effects on economic growth and employment over the medium term
- VAT was last adjusted in 1993, and is lower than the global and African average.

Comparative standard VAT rates by country*



**Rates are for 2017 & 2018. The OECD rate refers to an unweighted average*
Source: International Bureau of Fiscal Documentation

Other measures will support overall progressivity

- When investigating the introduction of a luxury VAT, the Katz Commission (1994) argued that any potential redistributive gains from multiple VAT rates were outweighed by its disadvantages
- Davis Tax Committee (2015) found no evidence globally that higher VAT rates on luxury goods meaningfully improved equity in the VAT system:
  - multiple VAT rates add significantly to complexity and administrative burden
  - Ad valorem excise duties are already charged on a number of luxury goods (increasing the price on which VAT is charged)
- Additional VAT rates require further enforcement and more SARS resources
- Multiple VAT structures significantly increase administrative complexity, admin burden and creates opportunities for avoidance
- As per DTC recommendations, ad-valorem excise duties are a better option
- Government is rather proposing to <u>increase ad valorem excise duties from 7% to 9% and an increase in the cap on motor vehicles from 25% to 30%</u>, ensuring that households spending more on luxury goods contribute proportionately more
- The <u>higher estate duty rate of 25 per cent for estates above R30 million</u> acts as a proxy wealth tax and improves the progressivity of the tax system

Ad-valorem excise duty products

Tariff item	Article description	Tax rate
118.15	Perfumes & toilet waters	7%
118.20	Lip make-up preparations	5%
	Eye make-up preparations	5%
	Manicure & pedicure preparations	5%
	Powders	5%
118.33	Fireworks	7%
120.10	Fur – apparel	7%
124.05	Air conditioning machines – buildings not exceeding 8.8 KW	7%
124.37	Telephones - cordless	7%
	Cellular phones	7%
124.40	Loudspeakers	7%
	Electric amplifiers	7%
124.45	Sound recording or reproducing apparatus	7%
124.55	Video recording and reproducing apparatus	7%
124.66	Cameras: Television, digital and video	7%
124.70	Reception apparatus for radio-broadcasting	7%
	Radio-broadcast receivers – used in motor vehicles	7%
124.75	Monitors	7%
	Televisions, decoders	7%
	Projectors	7%
126.02	Motor vehicles: passenger cars & goods - LVCs not exceeding 5 ton	Formula
126.04.15	Golf carts	7%
126.10	Motorcycles	7%
126.20	Water scooters	7%
129.10	Revolvers, pistols, shot guns, etc.	7%
130.10	Casino games - games of skill	7%
	Video games	7%
130.15	Golf balls	7%

Zero-rating will mitigate the impact on the poor

- The VAT proposal increases the cost of living for all households, including the poor
- The impact on the poor is mitigated through:
  - The zero rating of basic food items and paraffin; and
  - Above-inflation increases in social grants
- The VAT zero-rating system remains in place – consumers do not pay VAT on 19 basic food items, including dried beans, samp, maize meal and rice
- Study by the World Bank and local academics shows that zero-rating makes the VAT system slightly progressive (would be regressive without zero-rating)
- Reducing inequality is crucially important, but the VAT system is not the best instrument for achieving redistributive goals
  - Zero-rating will assist poor households, but not effective in reducing inequality
- Even though most zero-rated items are mostly well targeted, there are a few food items, such as fruit, where higher-income households reap the most benefits
- A more efficient way to provide relief to the poor is through the expenditure programmes rather than through further zero-rating of food items

Initial response to VAT increase

- Nobody welcomes tax increases, so unsurprisingly, there was big response against the increase and that of the fuel levies
- SCOF and SECOF had joint hearings, heard NGOs and many other concerned with impact on the poor
  - Submissions were received from NGOs and others
  - Second round of submissions also for Rates Bill hearings
- Despite their objections, the committees approved the fiscal framework, as did Parliament
- One of the recommendations was for us to investigate further zero-rating, by joint committee & the Cabinet Statement issued on 28 February 2018,
- Minster of Finance appointed a panel, whose mandate was to:
  - Evaluate current list of 19 zero rated food items
  - Consider the inclusion of additional zero-rated items that will achieve the policy intention of providing relief to poor and low-income households, and
  - Consider other measures (i.e. expenditure programmes) to mitigate the impact of the increase on poorer households

Recommendations from the Panel Report

- The report recommended the following additional items to be included in the basket of zero rated goods:
  a) White bread, bread flour and cake flour;
  b) Sanitary products;
  c) School uniforms; and
  d) Nappies, including cloth and adult nappies.
- It further recommended that government should expedite the provision of free sanitary products to the poor;
- Zero-rating of school uniforms should be done only if it can be separated from general clothing;
- The panel suggested that NT does further work to "ensure that the benefits of zero-rating accrue to consumers and are not captured by producers";
- The report also highlighted strengthening of the National School Nutrition Programme and increases in the Child Support Grant and Old Age Pension to assist poorer households

Consultation process on Panel report

- The Minister of Finance received the Report of the Independent Panel of Experts on 06 Aug 2018
- As was the case with the reports of the Davis Tax Committee, the panel's report provides the Minister of Finance with a set of recommendations
- The report was released on 10 Aug 2018 for further public comment, including comments to be made during Parliamentary hearings
- Comments closed on 31 Aug 2018
- National Treasury reviewing those comments and preparing a formal response document to be provided to SCOF on 16 October 2018
  - Received 316 written submissions and over 30 000 comments through two petitions
  - Note that many of the comments are directly asking for additional products to be zero rated
- Four rounds of consultation (Budget process, Rates Bill, Panel report, Comments on panel report)

Additional requests for zero rating in comments

- Fresh and frozen poultry (pieces and whole).
- Bread flour.
- White bread.
- White and brown Sugar.
- Canned beans.
- Margarine.
- Polony.
- Basic and essential medicines (and Medical services)
- Matches and candles.
- Coal and coal stoves.
- Hotplates
- Soap and washing powders.
- Essential toiletries.
- Pay as you go cell phone costs
- Public education and education-related goods, e.g. stationery, textbooks and uniforms.
- Energy saving appliances.
- Water and domestic electricity:
- Mopane worms, other canned fish, Whiteners (Cremora; Ellis Brown), Amageu, Baby food, Powder soup, Instant yeast, Soya product (excluding soy milk), tagless tea bags, Infants and children's clothing and footwear,
- Peanut butter, oily fish, oats
- Assistive devices
- Vaseline, polish and other basic cosmetics, Oros, Jam, Rama and butter, data

Additional zero-rating and the objectives of the tax system

- South Africa has an efficient VAT system with a broad base, which allows for a lower rate
- Tax is a blunt tool to try and achieve distributional objectives:
  - Davis Tax Committee advised against further zero-rating, saying that zero rating will "not provide any tangible benefit to poorer households" and that reducing the rate on products will only "partially be reflected in prices, or not at all".
  - Better to achieve progressivity through the personal income tax regime and target benefits to lower income households through public expenditure
- Further zero rating will reduce tax revenues and shrink the tax base
- Allowing a large number of additional items to be zero-rated will undermine future tax revenues and set a precedent for more and more exceptions
- Zero-rating COMPLICATES the VAT system and opens up the system to greater fraud and requires greater administrative oversight from SARS

Distributional impact of zero rating

- Tax is a blunt tool to use in assisting poorer households
  - The majority of the lost tax revenue from further zero-rating will accrue to higher income households.
- Panel report states that for all the recommended items, further work should be done "to ensure that the benefits of zero rating accrue to consumers and are not captured by producers".
  - There is no guarantee that producers will lower their prices if a product is zero rated. If prices remain the same, the full revenue loss will benefit producers
- Zero rating will not solve problems of affordability. Even if producers were to lower their prices by a portion of the VAT amount, necessities may still be unaffordable for lower income households
- Better outcomes for poorer households could be achieved through targeted expenditure programmes, which was recommended by panel.
  - However, panel report expressed doubts over ability of government to implement targeted expenditure programmes effectively

Fiscal position is under severe pressure

- The fiscal position is substantially weaker than at any time since 1994, including at the time of the 2008 financial crisis, when South Africa had a gross debt-to-GDP ratio that was just above 26 per cent. That ratio now stands at around 55 per cent.
- Tax revenue collections over the last two years substantially underperformed compared to forecasts made at the beginning of the year, with revenue shortfalls of R30.7 billion and R49.1 billion in 2016/17 and in 2017/18. These under-collections occurred even after significant increases in personal income taxes and fuel levies.
- Recent revenue under-collections have continued to put immense pressure on the fiscus – MTBPS estimates another large shortfall of more than R27bn for 2018/19
- Large additional expenditure pressures from
  - Higher than budgeted wage increases for civil servants
  - Potential capital injections for State Owned Entities
  - Need for greater infrastructure spend
  - Social expenditure programmes, such as NHI
- Zero rating will reduce revenue and require tax increases or expenditure cuts

MTBPS announcement on zero-rating

- Given the considerable fiscal constraints, the ineffectiveness of using zero-rating to address distributional concerns and the risks from undermining the VAT system, it is proposed that only a few of the recommendations from the panel report are considered.
- The Medium Term Budget Policy Statement (MTBPS) proposed that sanitary pads, white bread flour and cake flour are zero-rated as they are the most well targeted to poorer from 1 April 2019.
- It is proposed that the recommendations of the panel report regarding the free provision of sanitary products is implemented, and R79 million in expenditure has been allocated in the MTBPS.
- Further work should be completed by government on identifying expenditure programmes that directly target and benefit lower income households (on top of initiatives such as the Nutritional School Feeding Programme)

Increase in general fuel levy and RAF levy

- Although not in the Rates Bill, proposed increase in the general fuel levy of 22 c/l, will contribute R1.2 billion out of the R36 billion in increases
  - An inflationary increase would have been 17c/l which would not have generated any additional revenue as this was assumed in the forecasts
- Road Accident Fund levy increase of 30 c/l to help stabilize the Road Accident Fund

Table 4.4 Total combined fuel taxes on petrol and diesel

	2016/17		2017/18		2018/19	
Rands/litre	93 octane petrol	Diesel	93 octane petrol	Diesel	93 octane petrol	Diesel
General fuel levy	2.85	2.70	3.15	3.00	3.37	3.22
Road Accident Fund levy	1.54	1.54	1.63	1.63	1.93	1.93
Customs and excise levy	0.04	0.04	0.04	0.04	0.04	0.04
Total	4.43	4.28	4.82	4.67	5.34	5.19
Pump price[1]	12.69	11.11	13.55	11.96	13.90	12.57
Taxes as percentage of pump price	*34.9%*	*38.5%*	*35.6%*	*39.0%*	*38.4%*	*41.3%*

1. Average Gauteng pump price for the 2016/17 and 2017/18 years. The 2018/19 figure is the Gauteng pump price in February 2018. Diesel (0.05% sulphur) wholesale price (retail price not regulated)

Summary of the Rates Bill

- **Clause 1**
  - Introducing a higher estate duty rate of 25 per cent for estates above R30 million
- **Clause 2**
  - Fixing of rates of normal tax
- **Clause 3**
  - Increase in rebates primary, secondary and tertiary
- **Clause 4**
  - Increase in medical tax credits
- **Clause 5**
  - Introducing a higher donations tax rate of 25% for donations above R30 million
- **Clause 6**
  - Adjusting the formula (remuneration) for calculation of fringe benefit tax for residential accommodation
- **Clause 7**
  - Amendment of customs and excise Act to include the excise schedule dealing with increase in alcohol and tobbaco
- **Clause 8**
  - Increase in the VAT rate from 14 to 15 per cent
- **Clause 9**
  - Amendments to the VAT Act to take into account proposed changes to regulations prescribing E Services
- **Clause 10**
  - Amendments to the VAT Act to take into account proposed changes to regulations prescribing E Services

Summary of the Rates Bill

- **Clause 11**
  - Amendments to the VAT Act to take into account proposed changes to regulations prescribing E Services
- **Clause 12**
  - Amendment to Schedule 2 of the VAT Act to clarify the issue of Whole Wheat Brown Bread
- **Clause 13**
  - Short title of the Act