Business Parliamentary Office

A conduit for effective organised business – parliamentary advocacy

Comprising Business Unity South Africa (BUSA) and Chambers of Commerce and Industry South Africa (CHAMSA)

Submission to the Portfolio Committee on Finance

Parliament of the Republic of South Africa

Public Hearings on the 2008 Budget Statement

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CONTACT INFORMATION

Business Parliamentary Office
9 Church Square (1st floor)
Cape Town
P.O Box 3867,
Cape Town 8000
Republic of South Africa
Tel: +27 21 465 1633
Fax: +27 21 – 461 5470
Website: www.bpo.co.za

Abdul Waheed Patel
Business Parliamentary Liaison Officer
Business Parliamentary Office
Tel: +27 21 – 465 1633
Fax: +27 21 – 461 5470
Mobile: +27 79 888 0452
awpatel@bpo.co.za

1. INTRODUCTION

This submission has been facilitated via the Business Parliamentary Office (BPO), acting as a conduit and dedicated facility servicing the parliamentary and legislative advocacy and engagement needs of the broader South African organised business sector. In representing the overarching business interest in the country and in ensuring that business plays a constructive role in the country's economic development and transformation, Business Unity South Africa (BUSA) has been the key contributor to this submission through the efforts of its Economic Policy Unit, the BUSA Economic Policy Standing Committee and the BUSA Standing Committee on Tax.

Business is appreciative of the opportunity afforded to it by Parliament's Portfolio Committee on Finance, to make submission on the 2008 Budget Statement recently presented before Parliament by the Honourable Minister of Finance, Mr. Trevor Manuel. We believe this in keeping with the rich tradition of the budgetary process over the past 12 years, which has been characterised by a willingness to engage organised business and solicit its input on the budget, as part of an open ethos approach to transparent fiscal-policy making within the national budgetary process.

In particular, we implore this esteemed committee of Parliament to actively uphold and sustain this proud tradition. It is our view that this in consistent with the overall theme of the budget as articulated by the honourable Minister Finance, when he said: "*We are in these together ... rich and poor, urban and rural, men and women, business and community organisations, labour and government*".

Having previously and on numerous occasions complimented the budgetary process within parliament as a hallmark of participatory parliamentary democracy in action, organised business – being close to the pulse of the nation's economy and the reality of business on the ground, would be the first in a long line to advocate for a sustained commitment to this principled and open ethos approach by government and Parliament itself, as it relates to actively engaging and involving business as a key component of civil society in the budgetary process.

In the context of our current economic planning and policy trajectory, as well as the context of an economy that increasingly interconnected to the global marketplace, this principled and open ethos approach must continue to characterise the nature of engagement and public participation around the budget within parliament, as part of sustained and determined efforts to strengthen parliamentary democracy itself.

This is a necessary condition for ensuring a shared responsibility and commitment to address our common economic challenges and priorities, in as much as we all seek to derive the economic good fortunes that accrue to us all from a successful and effective onslaught in addressing these challenges and priorities. It is an approach to the budget within the context of parliamentary democracy, that is equal in measure to the very nature of the economic, policy and fiscal posture contained in the budget itself, in order to achieve the outcomes desired by our government and is thus central to the notion of a budget that is legitimate, credible and which carries the highest level of popular support.

In this regard, we welcome the strong sentiment communicated by the Minister himself during his post-budget commentary as it relates to the importance of the parliamentary oversight and processes around the budget. The budget cycle must therefore be seen as a continuous process which requires all relevant stakeholders – including the South

African business sector, to engage meaningfully with the process throughout the fiscal year, to ensure that the macro-output reflects the difficult policy decisions taken by our government.

We believe that fiscal policy alone cannot be expected to tackle South Africa's challenges. Whilst fiscal and monetary policy can go a long way in creating a favourable macro-economic environment – it is important that other policy instruments and government departments and agencies contribute their share to unlocking South Africa's growth potential.

In this regard, the oversight role of parliamentary committees in focusing on the micro-level challenges and paying attention to the detail which inhibit the attainment of service delivery and economic growth priorities identified in the budget cannot be overemphasised. This requires continued investment to be made in developing capacity in all three spheres of government as well as the legislature, to ensure appropriate measures that enhance accountability and monitoring framework within all department and agencies of government.

As articulated above, the oversight role of this committee is crucial. Because "*we are in these together*", organised business through its mechanisms for engaging the legislature (as a forum and platform for national dialogue), is amenable to and welcoming of, the opportunity to proactively contribute to meaningful and constructive dialogue within parliamentary processes on matters of strategic importance to our national economic growth and development efforts e.g. the debate around the current electricity situation.

Whilst the budget statement was fairly broad the commentary contained in this submission will be limited to the following salient issues, namely:

- Funding to Eskom
- Fiscal incentives for energy efficiency products and services
- Infrastructure
- Human Capital Investment and "the war on poverty"
- Industrial development
- Tax matters

2. BUDGTARY ANALYSIS

BUSA supports the "balanced" budget tabled by Minister Manuel. It is the view of business in South Africa that the budget provides much needed stimulus to the economy and continues along an established path taken by the National Treasury over the years to provide a stable macroeconomic environment in South Africa. This is particularly important given the predicted slowdown in both the global and local economy. The budget went further and emphasized South Africa's commitment to addressing supply constraints and resolving our socio-economic challenges.

It is widely recognised that South Africa in unlikely to meet the AsgiSA target of an average growth rate of 6% by 2014. The concern for business remains the extent to which we can grow our economy in a sustainable manner. In BUSA's view the "war on poverty" can only be won through growing the economy. The stated 6% growth rate, which would double the size of the South African economy every twelve years, is a growth rate that can help to meaningfully address these challenges.

2.1 Funding to Eskom

The R60 Billion allocation to assist Eskom ease its short-term funding challenges is supported and signals government's commitment to restoring security of electricity supply in South Africa. However, the terms and details of the funding arrangement will need to be studied further once available.

2.2 Fiscal Incentives for energy efficient products and services

The additional allocation of R2 Billion over the next three years for promoting more efficient electricity usage, generation from renewable resources and installation of energy-saving devices is also appropriate. In our view, this allocation must be accompanied by a range of other fiscal incentives which will promote energy efficiency. South African business expects that further details will be provided about how the funds will be allocated and the administration thereof.

BUSA and the general public accept that electricity from non-renewable sources is harmful to the environment. However, at this juncture, we are questioning the appropriateness of the introduction of the 2c per kwh levy on electricity generated from non-renewable sources; especially when the consumer does have not an alternative but to utilise such electricity due to a highly regulated environment where Eskom is the sole generator and supplier.

The argument advance in support of this measure relates to a 'stop-gap' saving measure (arising from the energy debacle), on to which on to which has been tagged an environment protection theme. BUSA is prepared to participate in the electricity savings programme and is presently playing a leading and facilitative role together with government and Eskom, to mobilise the active participation and stewardship by South African business to address the current national emergency and mitigation interventions of the state.

BUSA is also sensitive to environment degradation and measures to overcome such degradation. However, Business is not well disposed to levy measures for whatever purpose. Too often there is obscurity and a lack of accountability as to the deployment of such levy funds. Of the R4 billion to be generated, the bulk will come from Business.

2.3 Infrastructure

BUSA supports the additional investment in infrastructure that is planned by government. The increase in allocations by a total of R17 billion to the budgets of the departments of housing, provincial and local government, water affairs, sport and recreation and transport over the next three years, mainly for infrastructure should assist service delivery at local levels. We also welcome the R11 Billion public transport infrastructure – it should improve the efficiency of our transport network thereby increasing labour productivity through reducing commuting times.

Transnet's investment programme in excess of R78 billion is also supported, especially investment plans for our rail and ports infrastructure. Chair, it is also our opinion that the allocations to Transnet must be accompanied by an appropriate review of the regulatory environment within sectors where Transnet operates to investigate if there is scope for improving efficiencies.

2.4 Human Capital Investment and the "*war on poverty*"

It is appropriate for the budget statement to articulate on allocations aimed at boosting critical social and human development programmes. Such investment should assist in the development of productive capacity in our economy thus increasing our rankings in terms of global competitiveness and is also be targeted at meeting the underlying socio-economic objectives. The allocations made by the Minister in respect to social welfare, education, health and crime prevention are supported and we share the minister's analysis that investment in human capital is at the heart of our "war on poverty".

2.5 Industrial Development

BUSA welcomes the additional allocation of an additional R2.3 billion for the Department of Trade and Industry over the next three years and tax incentives of R5 billion in support of industrial investment and employment creation to support the broader industrial policy objectives. Again, BUSA will review details of such incentives and their administration.

2.6 Tax matters

A wide spectrum of the membership of BUSA has acknowledged the clear intention of this year's tax proposals to stimulate economic growth by potentially reducing the cost of doing business and by supporting industrial incentives.
Most businesses would also go along with measures to reduce electricity demand and all responsible members of the business community would be sensitive to environmental degradation and would welcome steps taken by the fiscus in support of sustainable development.

BUSA particularly welcomes the opportunity to give input on the taxation proposals in this year's Budget Review because, perhaps more so than in previous years, there are many proposals which need to be fleshed out in order for the economy to derive the optimal benefit intended by National Treasury. BUSA therefore looks forward to engage with the detail of the taxation proposals during the forthcoming public hearings on the Taxation Laws Amendment Bill(s).

2.6.1 <u>Macro Taxation Environment</u>

a) The Tax to GDP Ratio

BUSA remains concerned that the overall tax to GDP ratio has been on the increase (to the current ± 28%) despite regular and significant tax relief granted to taxpayers over the past decade. This has implications for the perceived competitiveness of our tax environment and tax policy going forward.

b) Split between Direct and Indirect Taxation

At policy level the split between direct taxation and indirect taxation (which is in the order of 60%:40%) needs continuous attention. The fact that the individual direct taxation base is a relatively narrow one and that the corporate tax base is cyclical by nature, are pertinent considerations.

c) Tax Administration and Collection

The most important macro taxation issue is the ability of the fiscus to efficiently administer and collect taxes. BUSA would like to congratulate SARS on celebrating its 10th anniversary on the 1st October 2007 and to be able to report the first reduction in the cost to collection ratio (from 1.23% to 1.04%) for many years.

2.6.2 <u>The Business Environment</u>

a) The Corporate Income Tax Rate

There can be no doubt that the significant increase in the relative contribution of corporate income tax (from 10.5% in 1999/00 to more than 25% currently) is not only the result of cyclical growth in corporate profits. There has also been a fundamental and sustainable broadening of the corporate tax base as is, inter alia, evidenced by the dramatic narrowing of the gap between the "headline" corporate income tax rate and the "effective" rate of tax paid by companies. This provided a sound rationale for the reduction of the headline rate to 28%. BUSA welcomes the R5Bn that could be restored to the corporate sector this year, but more so, the message that this will send both locally and abroad.

b) STC Reforms

BUSA is on record as supportive of the replacement of STC with a withholding dividend tax. This is an area where certainty and predictability is of the utmost importance as it has a direct bearing on distribution of profits. BUSA welcomes the confirmation that the withholding tax rate will be 10% and that tax treaties may provide for a lower rate of e.g. 5%. The proposed exemption of pension funds, government entities and public benefit organizations is consistent. Effective exemption should also apply to all intra-company dividends (cascading relief) to avoid double taxation. Dividends paid to so-called "closely held (passive) companies" should not cloud this principle.

c) So-called "Closely held (Passive) Companies"

The proposed penal taxation (40% on the first Rand) of these strange and ill-defined companies is widely regarded as problematic. Whilst the potential threat of tax arbitrage is understood, the proposed anti-avoidance measure seems like a very blunt instrument indeed. Questions are being asked as to why the recently introduced general anti-avoidance rule (GAAR) cannot deal with any real tax avoidance in this context. BUSA believes that alternatives should be explored urgently to avoid a situation where unproductive time, effort and money would have to be spent on the unwinding of perfectly legitimate structures set up for estate planning or even business purposes.

d) Simplified Tax System for Small Business

The measures introduced by Government in recent years to assist the development and sustainability of small business operations are fully supported by business generally. The proposed turnover based presumptive tax will address the most pressing tax concern of very small businesses, viz the administrative cost of tax compliance. The elective and wide ranging nature of this new regime (extending to incorporated as well as unincorporated enterprises) is welcomed by BUSA, but the turnover limit of R1M seems to be on the low side, given inflationary expectations for 2008/09.

e) Venture Capital Incentives

BUSA is particularly supportive of this measure. The so-called "business angel" concept has proved to very effective in other tax regimes and there is no reason why this should not be the case in South Africa – provided the playing field is level and red tape is minimized. BUSA notes that specified industrial sectors feature in the proposal (i.e. "high growth and high-tech companies"). The question must be asked if it is necessary for bureaucrats to decide who are and who are not potential winning industries. Surely this is a prime case where the venture capitalist / investor should assess and pick his / her own winners.

f) Industrial Policy Incentives

BUSA would like to be part of the design of this programme. On the one hand there is the long standing view that a broad based lowering of the corporate tax burden is the better policy route because governments seldom have a clear quantitative and qualitative understanding of the effectiveness or the revenue impact of specific incentives. On the other hand there is the view that we have reached the stage where some of the sector specific binding constraints can be addressed through well targeted and managed tax incentives. (The current urban development zone incentive seems to be a case in point). In the final analysis the appropriateness of a specific tax incentive is perhaps best judged if seen as a "subsidy" paid by the general body of taxpayers. BUSA therefore believes that public accountability is a critical component of initiatives like these and would urge that regular reviews and assessments of progress be published to enable effective and informed monitoring and oversight.

2.6.3 Employer Provided Benefits

a) Bursaries

BUSA as an apex employer body welcomes the meaningful adjustment of the monetary cap from R3 000 to R10 000 per annum i.r.o fringe benefit tax free bursaries to dependents of certain employees. The extension of the earnings threshold from R60 000 to R100 000 per annum is also welcome.

b) Share Incentives

In support of broad based share incentives, BUSA also welcomes the announced relaxation of criteria (from 90% to 80% participation) and the increase in the monetary limit from R9 000 to a much more meaningful R30 000 over three years.

c) Low cost Housing

BUSA fully supports the urgent review of the rather low deductible limit of R6 000 i.r.o employer provided low cost housing. Further relief i.r.o. fringe benefit taxation in the hands of employees would support this initiative. BUSA is encouraged by the other creative suggestions in this area of critical national importance and would like to engage with Government to facilitate optimal private sector participation.

2.6.4 Environmental Conservation

a) "Cleaner" Technologies

BUSA has noted the various considerations i.r.o. emission changes and tax incentives for "cleaner" production technologies. Once again this is an area where the private sector should be closely involved in order to ensure effective targeting.

b) Biodiversity Conservation

The proposals to encourage private land owners to preserve habitats and biodiversity are fully supported by BUSA. Apart from conservation considerations per se, South Africa's unique biodiversity profile is at the root of a growing ecotourism industry which contributes significantly to GDP.

2.6.5 <u>Social Security and Retirement Fund Reform</u>

BUSA reiterates the view that this is one of the most important policy issues facing South Africa. We welcome the comprehensive progress report in Chapter 6 of the Budget Review. There is a feeling amongst certain members of BUSA that progress has been rather slow since very specific announcements were made in the State of the Nation Address last year. However, there is also a deep understanding about the magnitude of the task at hand. BUSA remains fully committed to contribute meaningfully to the NEDLAC negotiations. We would urge that the reform process be holistic (as intended) and that a greater sense of urgency should prevail.