4

Fiscal policy

Overview

Economic growth is the prerequisite for reducing poverty and improving livelihoods. By offsetting the effects of the business cycle, countercyclical fiscal policy contributes to growth and job creation. When the economy is doing well, the budget balance improves to build fiscal space, limit increases in the cost of financing and counteract inflationary pressures. When the economy is underperforming, government allows the budget balance to deteriorate, using the fiscal space built up beforehand to fund expenditure and stimulate economic activity.

The countercyclical fiscal stance contributes to economic growth and job creation

Owing to sound management of the fiscus during the preceding six years of strong economic growth (2002-2007), government entered the 2008-2009 recession with healthy public finances and a comparatively low level of debt. This allowed for a flexible response to deteriorating economic conditions. Spending increased to reinforce the social security net during a period of exceptional hardship for many South Africans, and provided an economic stimulus through the infrastructure programme.

To ensure that public expenditure is not crowded out by an ever-rising interest burden, government debt needs to be managed sustainably. Long-term fiscal planning, predictable actions and credible policies create confidence in the future of the economy. South Africa's ability to continue building roads, schools and hospitals will depend on how quickly the economy grows, the long-term level of spending, and the choices made about financing social programmes.

Government debt needs to be managed sustainably

The projected budget deficit in 2010/11 is R142.4 billion, or 5.3 per cent of GDP. As economic growth strengthens, and tax revenue recovers, government will reduce the budget deficit gradually to 3.8 per cent of GDP by 2013/14.

The budget framework

Table 4.1 summarises the medium-term budget framework. Key features of the 2011 Budget include the following:

- Tax revenue increases from 25.2 per cent of GDP in 2010/11 to 26.2 per cent in 2013/14
- Baseline expenditure additions total R94.1 billion
- Real non-interest expenditure growth averages 2.8 per cent a year
- Debt-service costs rise from 2.5 per cent of GDP in 2010/11 to 2.9 per cent by 2013/14
- The budget deficit improves to 3.8 per cent in 2013/14.

Table 4.1 Consolidated government fiscal framework, 2007/08 – 2013/14

R million	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14
		Outcome		Revised estimate		Medium-term estimates	
Revenue	**626 705**	**682 997**	**664 840**	**755 023**	**824 466**	**908 714**	**1 017 187**
Percentage of GDP	*30.1%*	*29.5%*	*27.2%*	*28.3%*	*28.3%*	*28.4%*	*28.8%*
Expenditure	**591 522**	**710 523**	**825 917**	**897 376**	**979 265**	**1 061 582**	**1 151 773**
Percentage of GDP	*28.5%*	*30.7%*	*33.8%*	*33.6%*	*33.6%*	*33.2%*	*32.6%*
Budget balance	**35 183**	**-27 526**	**-161 076**	**-142 353**	**-154 799**	**-152 868**	**-134 586**
Percentage of GDP	*1.7%*	*-1.2%*	*-6.6%*	*-5.3%*	*-5.3%*	*-4.8%*	*-3.8%*
Gross domestic product	*2 078 822*	*2 312 965*	*2 442 593*	*2 666 894*	*2 914 862*	*3 201 299*	*3 536 002*

Government will consolidate the fiscal position in line with economic growth

Over the next three years, as economic growth strengthens, government will consolidate the fiscal position by moderating the rate of expenditure growth. Priority spending will continue to be financed as government stabilises its borrowing. Fiscal policy will maintain this trajectory as long as economic growth continues to strengthen, rebuilding fiscal space to respond to future crises.

National Treasury proposes fiscal guidelines for South Africa

'Nothing is free, absolutely nothing ... it is paid for from revenue collected from those who pay taxes.' – President Jacob Zuma

The current debt crisis in several European countries, which has tested the durability of the currency union, is a stark reminder that fiscal mismanagement can make social programmes unaffordable. During 2010, Parliament asked the National Treasury to investigate how government could sustainably afford its expenditure over the long term. In response, the National Treasury is proposing guidelines for sustainable management of the public finances. The guidelines are informed by three principles:

- Countercyclicality: The budget balance should be set to counteract variations in the business cycle.
- Long-term debt sustainability: Spending levels must ensure that debt and interest costs do not rise indefinitely.
- Inter-generational equity: The long-term costs of spending programmes should be considered.

Developing fiscal policy based on these principles will strengthen parliamentary oversight of the budget process, encourage greater transparency and enhance public accountability. It will also facilitate sustainable progress on the New Growth Path by encouraging investment, a more stable economy and higher growth. To give effect to these principles, the National Treasury proposes that government:

- Adopt an annual target for the structural budget balance consistent with long-term growth, the desired level of public debt and inter-generational considerations.
- Make explicit the costs of existing and new programmes that require a long-term commitment.
- Set out a timeline to bring the budget back on target following large fiscal shocks.

Revenue

Tax revenue expected to recover as economy grows and tax base broadens

Tax revenue, which accounts for most revenue available to government, has become more sensitive to changes in the economic cycle since the tax base was restructured in the early 1990s. As a result, tax revenue tends to accelerate when the economy is doing well, and to slow sharply when the economy is underperforming. If revenue does not cover expenditure, borrowing is a short-term solution, but higher government expenditure as a share of GDP ultimately requires a growing tax base or higher tax rates. At the height of the recession in 2009/10, revenue underperformed expectations by R60.6 billion. Over the medium term, tax revenue is expected to recover as the economy grows and the tax base broadens.

Figure 4.1 Structure of tax revenue, 1996/97 – 2013/14

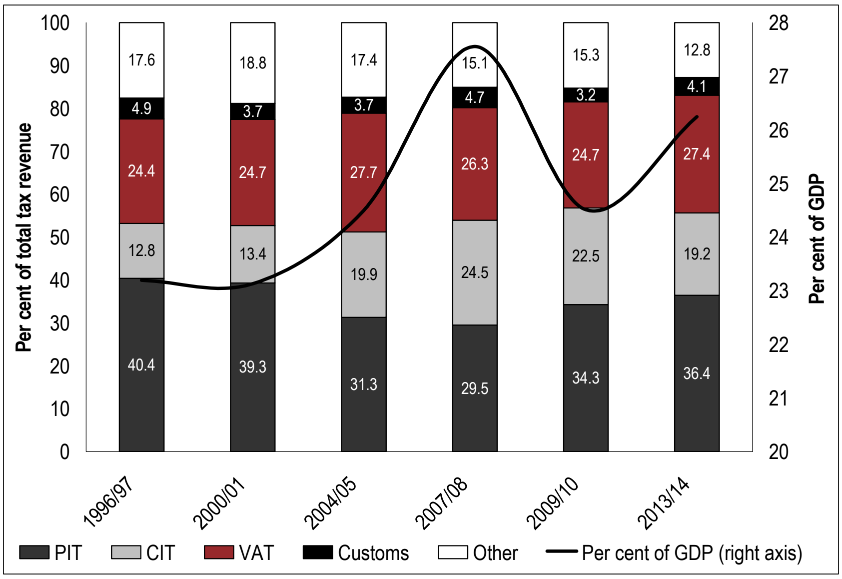


Table 4.2 presents consolidated government revenue outcomes from 2007/08 to the present, and the three-year projection.

Table 4.2 Consolidated government revenue, 2007/08 – 2013/14

R million	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14
		Outcome		Revised estimate		Medium-term estimates	
Tax revenue	**572 815**	**625 100**	**598 705**	**672 200**	**741 620**	**827 310**	**927 960**
Percentage of GDP	*27.6%*	*27.0%*	*24.5%*	*25.2%*	*25.4%*	*25.8%*	*26.2%*
Non tax revenue[1]	12 693	12 616	8 889	12 254	10 001	11 540	12 351
of which:							
Mineral royalties	–	–	–	*3 712*	*4 890*	*5 150*	*5 430*
Estimate of SACU payments[2]	-24 713	-28 921	-27 915	-14 991	-21 763	-32 432	-35 997
Other adjustment[3]	–	–	–	-2 900	–	–	–
Provinces, social security funds and selected public entities	65 910	74 201	85 162	88 460	94 609	102 296	112 873
Budget revenue	**626 705**	**682 997**	**664 840**	**755 023**	**824 466**	**908 714**	**1 017 187**
Percentage of GDP	*30.1%*	*29.5%*	*27.2%*	*28.3%*	*28.3%*	*28.4%*	*28.8%*
Gross domestic product	*2 078 822*	*2 312 965*	*2 442 593*	*2 666 894*	*2 914 862*	*3 201 299*	*3 536 002*

1. Includes mineral and petroleum royalties, mining leases and departmental revenue.
2. Estimates are based on National Treasury projections. Actual payment will be determined by outcomes of customs and excise revenue collections in line with the SACU agreement.
3. Payments to SACU partners in respect of a previous error in calculation of the 1969 agreement.

Payments to SACU partners have been revised upwards as customs revenue has begun to recover

Non-tax revenue, made up of departmental revenue and mineral royalties, remains about 0.4 per cent of GDP over the forecast period. Changes in interest income and dividend payments account for revisions to departmental revenue estimates since February 2010. Revenue from mineral royalties is expected to be higher than projected a year ago given high commodity prices. Payments to South Africa's Southern African Customs Union (SACU) partners have been revised upwards as a result of a recovery in customs and excise revenue since 2009/10.

Budget revenue also includes revenue from the social security funds, provinces, the RDP Fund and extra-budgetary institutions. According to the medium-term projection, social security fund revenue will benefit from increased contributions to the Unemployment Insurance Fund and Compensation Funds, while a higher fuel levy (see Chapter 5) will boost income for the Road Accident Fund. Provincial and extra-budgetary institution revenue is expected to remain in line with previously published estimates.

The financial crisis and Southern African Customs Union reforms

Botswana, Lesotho, Namibia, Swaziland and South Africa are members of SACU. The customs and excise revenue of each member state is collected in a common revenue pool, distribution of which is governed by a revenue-sharing formula. SACU revenues make up between 20 and 70 per cent of total government income for South Africa's SACU partners.

The global downturn has resulted in a major loss of income to the SACU common revenue pool. As a result, Botswana, Lesotho, Namibia, and Swaziland have taken steps to adjust their public finances:

- On the revenue side, measures include the introduction of VAT (Swaziland), increases in VAT rates and taxes (Botswana, Lesotho, Swaziland), and improved tax administration (Botswana, Lesotho, Swaziland).
- Spending reductions are planned for public-sector wages and non-priority consumption expenditure.

The dependency of South Africa's fellow SACU members on the volatile revenue pool resulted in a decision by the Council of Ministers to review the arrangement. The goals of this review are to identify a more equitable distribution of revenue and to enhance economic integration. An independent study has recommended the following reforms:

- An entitlement based on the taxes that each country generates through customs and excise duties, combined with an adjustment based on the extent to which a member state benefits or is disadvantaged by belonging to SACU.
- A fund to support infrastructure and trade projects that promote regional integration and development.

Expenditure

Fiscal framework adds R94.1 billion to baseline expenditure over the medium term

The fiscal framework adds R20.7 billion to expenditure in 2011/12, R29.6 billion in 2012/13 and R43.8 billion in 2013/14, resulting in average real growth of 2.8 per cent in government non-interest spending over the next three years. These additions to baseline include:

- R26.3 billion to cover the carry-through costs of the 2010 public-sector wage agreement, including a 7.5 per cent cost-of-living adjustment and an R800 monthly housing allowance
- R23.9 billion allocated from the policy reserve for priority expenditure in job creation, skills, health and education
- R40.8 billion in adjustments to baselines for existing programmes, including education, health, public safety and social protection

- R3.1 billion allocated from the contingency reserve to provide flood and drought relief to provinces.

R30.6 billion in savings reprioritised over the MTEF

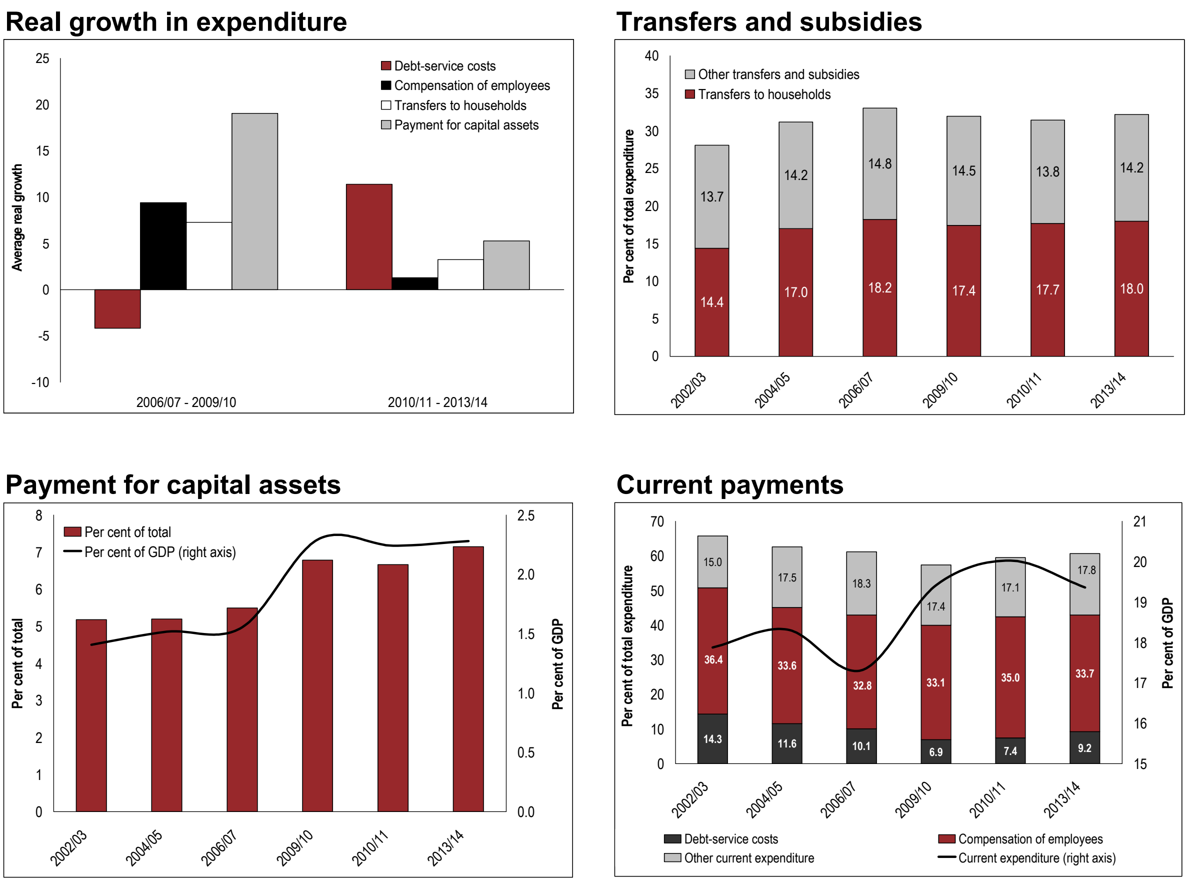
For the past two years government has worked to improve the efficiency of public expenditure. Total savings of R30.6 billion have been identified over the medium-term expenditure framework (MTEF) period and allocated to priority expenditure. Over the next three years, departments will be called on to increase support to effective programmes, and to cut or curtail ineffective ones. These plans are discussed in Chapter 8.

Balancing the composition of expenditure

Government has to balance capital and consumption expenditure

Government expenditure falls into two broad categories: capital spending and consumption spending (including wages, goods and services, and interest payments). Expenditure needs to be balanced appropriately to promote effective public-service delivery, and to ensure that spending contributes to economic growth without fuelling inflation.

Figure 4.2 Consolidated government expenditure



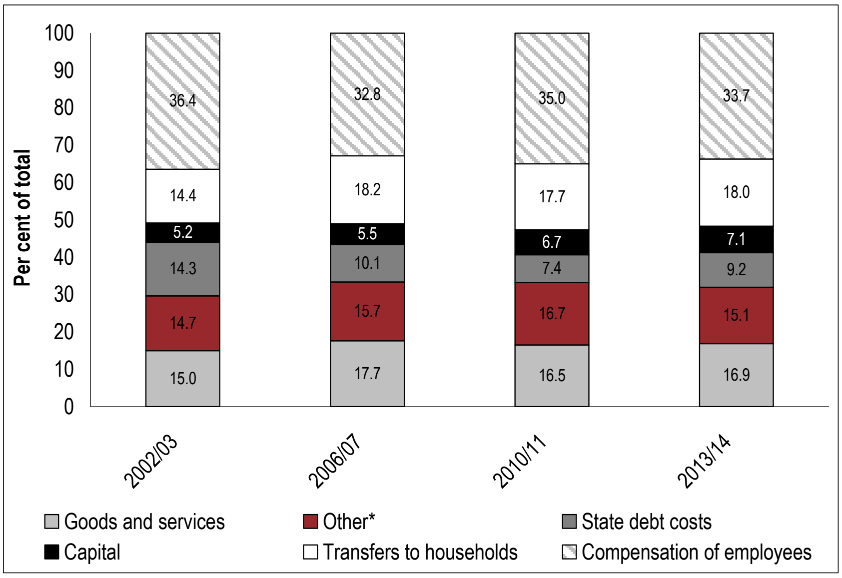
The 2010 public-sector wage negotiations resulted in a 7.5 per cent wage increase, which was 3.4 percentage points higher than the expected inflation rate. This required an extra allocation of R6.5 billion to cover compensation of employees in 2010/11.

Between 2002/03 and 2009/10 prudent management of the fiscus drove down debt-service costs as a percentage of GDP. During the recession, government borrowing increased, and as a result of the higher debt burden, interest costs are projected to be the fastest-growing area of expenditure over the medium term. As debt costs consume a rising share of expenditure over the next three years, government must ensure that it can maintain expenditure on social and economic priorities. A higher wage bill, in conjunction with a rising interest bill, can reduce spending on maintenance, capital investment, and public-service employment growth.

Framework makes provision for 6.6 per cent average annual growth in compensation

To cover wage increases and the additional employment, the proposed fiscal framework makes provision for 6.6 per cent average annual growth in compensation. Over this period, consumer price inflation is projected to average 5.2 per cent.

Figure 4.3 Structure of consolidated government expenditure, 2002/03 – 2013/14



**Other includes rent on land, payments for financial assets and other transfers*

15 million people depend on government transfers to households

Over the medium term, real growth in government transfers to households is projected to average 3.2 per cent. Nearly 15 million people now depend on some form of government grant, and for many households social security payments are the only regular source of income.

Since 2002/03, consolidated government spending on capital[1] has increased from 5.2 per cent of consolidated government expenditure to 6.7 per cent in 2010/11. Over the next three years, the rate of capital expenditure will slow moderately as higher interest costs, wage pressures and growth in social grants claim a greater share of expenditure.

Public-sector infrastructure

To meet present and future demand, and to grow the economy more rapidly, South Africa needs sufficient power to run factories, mines, schools and households; well-maintained road and rail networks to transport people and goods; and ports and pipelines to facilitate trade.

[1] Does not include expenditure on maintenance or capital transfers to municipalities and non-financial public enterprises.

Infrastructure expenditure includes spending on new buildings and fixed structures, as well as maintaining and rehabilitating existing structures. Infrastructure spending by the public sector, including municipalities and state-owned enterprises, supports priority economic and social objectives, and the job-creation goals of the New Growth Path.

Infrastructure programme works in tandem with the job-creation goals of the New Growth Path

Table 4.3 Public-sector infrastructure expenditure and estimates by sector, 2010/11 – 2013/14

R million	2010/11 Revised estimate	2011/12	2012/13	2013/14	MTEF Total	% of total
		Medium-term estimates				
Economic Services	**228 657**	**216 181**	**219 380**	**228 507**	**664 067**	***82.1%***
Energy	102 782	96 500	98 140	96 769	291 409	*36.0%*
Water and sanitation	20 990	26 836	25 367	28 196	80 400	*9.9%*
Transport and logistics	80 530	67 452	69 096	75 554	212 102	*26.2%*
Other economic services[1]	24 356	25 393	26 777	27 987	80 157	*9.9%*
Social services	**26 249**	**29 519**	**34 932**	**44 268**	**108 719**	***13.4%***
Health	8 546	10 256	15 114	20 624	45 993	*5.7%*
Education	6 757	9 155	10 092	11 487	30 735	*3.8%*
Community facilities	6 045	6 360	5 873	7 952	20 185	*2.5%*
Other social services[2]	4 902	3 749	3 853	4 205	11 806	*1.5%*
Justice and protection services[3]	**3 100**	**3 322**	**7 080**	**10 171**	**20 573**	***2.5%***
Central government administrative and financial services	**2 104**	**3 827**	**7 946**	**3 474**	**15 248**	***1.9%***
Total	**260 109**	**252 850**	**269 337**	**286 420**	**808 608**	***100.0%***
Percentage of GDP	*9.8%*	*8.7%*	*8.4%*	*8.1%*		
Gross domestic product	*2 666 894*	*2 914 862*	*3 201 299*	*3 536 002*		

1. Other economic services includes agriculture, environmental infrastructure, telecommunications, housing and industrial development zones.
2. Other social services includes labour centres, heritage institutions and national libraries.
3. Other justice and protection services includes the Legal Aid Board and private security industry regulatory authorities.

Public-sector spending on infrastructure has increased from 4.6 per cent of GDP in 2006/07 to 9.8 per cent of GDP in 2010/11, and is expected to average 8.4 per cent of GDP over the forecast period, totalling R808.6 billion. Economic services make up 82.1 per cent of infrastructure development over the medium term. Infrastructure projects in this category include power plant construction, transport network expansion and upgrades, and the provision of new sanitation and water infrastructure.

Medium-term public infrastructure spending projected at R808.6 billion

The social services category makes up 13.4 per cent of spending, of which education and health account for 3.8 per cent and 5.7 per cent respectively.

Reforming how government budgets for capital expenditure

Government will apply a systematic approach to appraising public-sector infrastructure projects to ensure maximum value for money invested.

The intention is to create a register of “shovel-ready” projects that have been fully costed and planned (including long-term maintenance), so that when funds become available through the budget, infrastructure investment can flow smoothly.

This approach will apply initially to all projects involving public-private partnerships; over time, it will begin to cover government’s mega-projects, in tandem with improved project appraisal capacity.

Table 4.4 Major infrastructure projects

Project name	Total project cost R billion	Implementation agent	Project objective and completion target date
Energy			
Kusile power station	142	Eskom	Construction of a 4 800MW coal-fired power station (to be completed in 2012).
Medupi power station	125	Eskom	Construction of 4 788MW coal-fired power station (to be completed in 2015).
Ingula pumped-storage scheme	15.6	Eskom	Construction of a 1 332MW hydroelectric power station (first unit to be completed in 2013).
Eskom's return-to-service projects	27	Eskom	Demothballing of three coal-fired power stations - Camden, Grootvlei and Komati (to be completed in 2012).
Transport			
Gauteng freeway improvement scheme	20.7	South African National Roads Agency Limited	Upgrade and lane additions to Gauteng's highway. Phase 1 (2012) and phase 2 (2020).
New multi-product pipeline phase 1	23.4	Transnet	Construction of a 8.7 billion litres per year pipeline (to be commissioned in 2011).
Iron-ore line	11.6	Transnet	Upgrade of the iron-ore line to 60 million tons per year (scheduled for completion in 2013).
Ngqura container terminal	10	Transnet	Improving port capacity by an additional 800 000 20-foot equivalent units (scheduled for completion in 2013).
Water			
Mokolo-Crocodile water augmentation project	15	Trans-Caledon Tunnel Authority	Phase 1 to deliver water (2012) and phase 2 (2015).
Olifants River water resource development project	16.1	Trans-Caledon Tunnel Authority	Construction of a dam and bulk distribution (to be completed in 2016).
Housing			
Cornubia housing development	5.1	The Housing Development Agency and eThekwini Metropolitan Municipality	Construction of 19 313 mixed-income, mixed-density houses (scheduled to be completed 2016/17).
N2 Gateway	2.3	The Housing Development Agency	The creation of sustainable communities through the construction of 22 000 low-income houses (scheduled for completion in 2013).
Hospitals			
Limpopo Academic Hospital	4	Limpopo Department of Health	Development of an academic hospital with tertiary facilities and services (scheduled for completion in 2013).
Nelson Mandela Hospital	4	Eastern Cape Department of Health	Improved health care through the upgrade and rehabilitation of the Nelson Mandela Hospital (scheduled for completion in 2013).
Chris Hani Baragwanath Hospital	4	Gauteng Department of Health	Improved health care through the upgrade and rehabilitation of the Soweto hospital (scheduled for completion in 2013).
Dr George Mukhari Hospital	4	Gauteng Department of Health	Improved health care through the upgrade and rehabilitation of the George Mukhari Hospital (scheduled for completion in 2013).
King Edward VIII Hospital	4	KZN Department of Health	Improved health care through the upgrade and rehabilitation of the King Edward VIII Hospital (scheduled for completion in 2013).
Correctional			
PPP Prisons	8	Department of Correctional Services	Upgrading of accomodation and related services to support the transformation process of correctional services facilities (scheduled for completion in 2013).

Over the forecast period, the bulk of economic infrastructure will be provided by non-financial public enterprises, which are projected to spend R392.6 billion. Provincial infrastructure spending is expected to total R150.3 billion, and municipal infrastructure spending R131.6 billion.

Capital spending continues to underperform budgeted amounts

Capital expenditure continues to underperform budgeted amounts. Since 2006/07, provincial capital expenditure has averaged about 86 per cent of allocated capital budgets. The municipal performance has improved from 72 per cent in 2006/07 to 85 per cent in 2008/09, before declining to 80 per cent in 2009/10. Non-financial public enterprises spent 72 per cent of their capital budgets in 2009/10.

The box below elaborates on the reasons for underspending.

Reasons for underspending on infrastructure

National government	• Lack of critical skills to plan, manage risk and execute projects • Service-level agreements between departments and implementing agents that are difficult to enforce • Lack of flexibility in choosing procurement and project implementation agents that would ensure delivery of projects on time and on budget
Provincial government	• Lack of integrated planning for health, education, housing infrastructure • Poor supply chain management, inadequate risk management • General lack of skills, especially in project management
Local government	• Unrealistic financial targets result in cost overruns and funding shortfalls • Inefficient supply-chain management • Subdued revenue levels • Lack of capacity to plan and meet requirements for conditional grants
Non-financial public enterprises	• Recession – Downward revisions in plans and a postponement of projects, higher borrowing costs, delays in drawing down World Bank loan to Eskom • Signoff deadlines on agreements between departments and commercial project partners not met or treated with urgency • Delays in procurement of inputs • Inclusion of projects on budget that are not yet ready for implementation • Decline in construction material costs, leading to lower budgets

The fiscal deficit

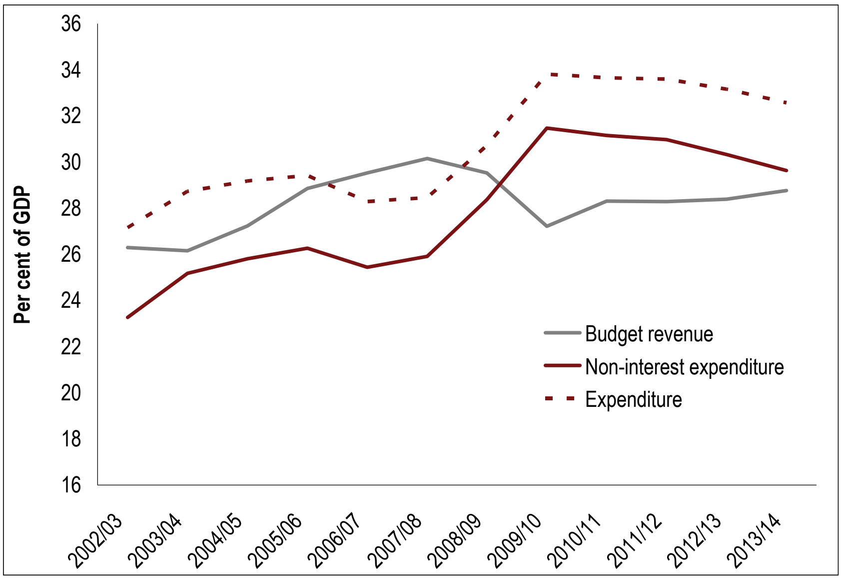
Borrowing to finance consumption is costly and unproductive

The fiscal framework supports a reduction of debt over time, which will reduce interest repayments and create fiscal space. Government borrowing to fund capital expenditure – such as the Gautrain – increases the overall wealth of the economy. Conversely, borrowing to finance consumption creates debt obligations that must be paid off long after the funds have been spent.

Moderating expenditure and recovering revenue will consolidate the fiscus over the medium term

Figure 4.4 shows the trajectory of the fiscus back towards long-term sustainability. The current position – the result of higher borrowing during the recession – is not sustainable over the long term. A moderation in the growth of expenditure, combined with a recovery in revenue, will consolidate the fiscus over the medium term. The projected improvement in the budget deficit is in line with the economic forecast.

Figure 4.4 Revenue and expenditure, 2002/03 – 2013/14

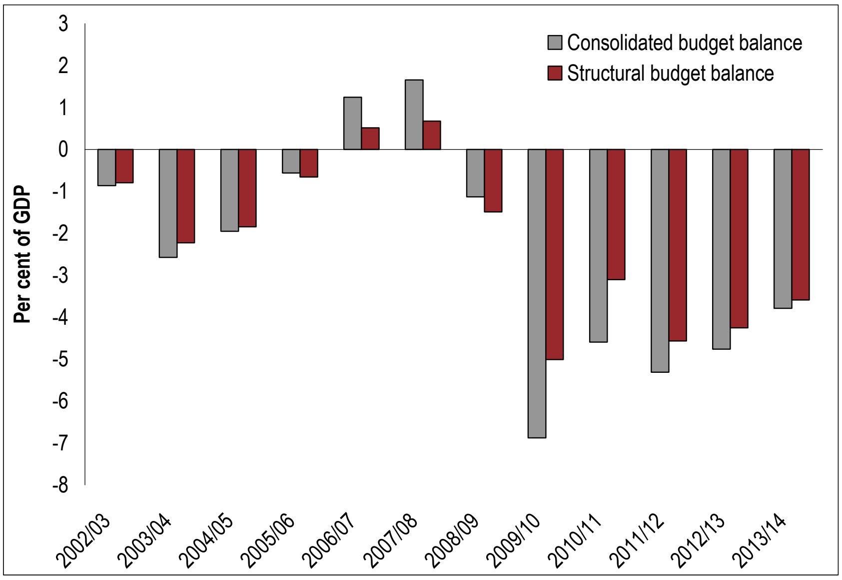


The 2010 Budget projected that debt stock would stabilise at about 44 per cent of GDP in 2015/16. As a result of improved economic growth, debt stock is now expected to stabilise at about 40 per cent of GDP in 2015/16. Any deterioration in the growth outlook, interest rates or the budget balance will prolong the fiscal recovery.

Structural budget deficit expected to improve to 3.6 per cent of GDP by outer year

Figure 4.5 shows the budget balance and the structural budget balance. The structural budget is a representation of what government revenue and expenditure would be if output were at its potential level, with cyclical variations stripped out. Over the next three years the budget deficit is projected to narrow to 3.8 per cent of GDP. Improvements in potential GDP growth should lead to a gradual rise in structural revenue. In combination with more moderate spending growth, this will lead to the structural budget deficit improving to 3.6 per cent of GDP by 2013/14.

Figure 4.5 Budget balance and structural budget balance, 2002/03 – 2013/14

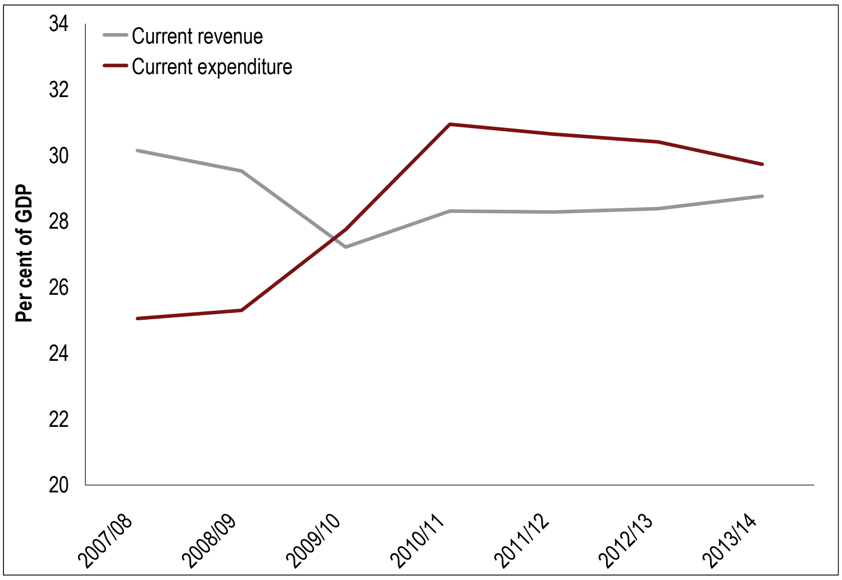


Savings

Over the past 30 years, corporate, government and household savings have gradually declined, and consequently the pool of resources available to fund investment from a domestic base has become smaller.

Savings represent domestic resources available to fund investment

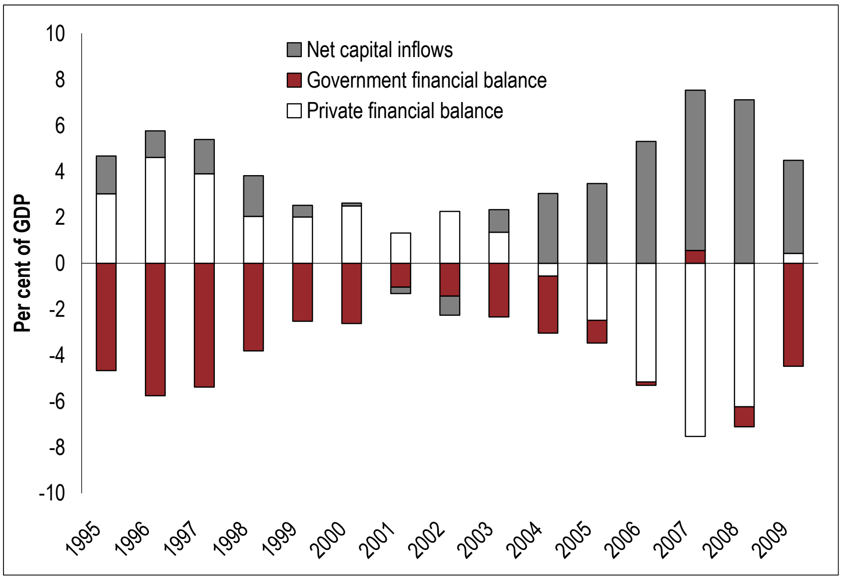
Figure 4.6 Current balance, 2007/08 – 2013/14



Government reduced its dissaving[2] between 2003/04 and 2007/08, and was able to effectively mobilise the savings collected during the growth period to fund revenue-generating capital projects. As government has drawn down savings, the fiscus has become reliant on foreign savings to finance the current balance and the capital investment programme.

South Africa has become more reliant on foreign savings to finance expenditure

Figure 4.7 Private, public and foreign savings, 1995 – 2009



Source: Reserve Bank

[2] An excess of current expenditure, including the depreciation of fixed capital, over current income.

A recovery in the current balance improves government savings

The current balance is the difference between current expenditure and current revenue, and acts as a proxy for government savings. Figure 4.6 shows that government is currently borrowing to finance short-term consumption. Long-term debt is being used to finance higher current expenditure on wages, interest and goods and services. An improvement in the current balance will lead to a recovery in government savings, reducing South Africa's reliance on capital inflows, as shown in Figure 4.7.

Revisions and forward estimates for the consolidated government budget

The budget deficit outcome in 2009/10 was R58 billion higher than projected. This was mainly due to lower-than-projected tax revenue collections of R60.6 billion, partially offset by under-expenditure of R8.4 billion. In 2010/11, a slower-than-anticipated recovery in revenue and continued growth in expenditure is expected to result in a deficit of R142.4 billion. Due to the improved economic and revenue outlook, as well as some savings on debt-service costs, the budget deficit is expected to be R26.2 billion lower than projected at the time of the 2010 Budget.

Table 4.5 Revised estimates of consolidated government revenue and expenditure, 2009/10 and 2010/11

	2009/10			2010/11			% change
R million	Budget estimate	Outcome	Deviation	Budget estimate	Revised estimates	Deviation	2009/10 – 2010/11
Revenue							
Tax revenue	659 304	598 705	-60 599	647 850	672 200	24 350	12.3%
Non-tax revenue	11 602	8 889	-2 713	10 380	12 254	1 874	37.9%
Less: SACU payments	-27 915	-27 915	-0	-14 991	-14 991	–	-46.3%
Other adjustment[1]	–	–	–	–	-2 900	-2 900	
Other[2]	88 245	85 162	-3 083	95 165	88 460	-6 704	3.9%
Budget revenue	**731 235**	**664 840**	**-66 395**	**738 404**	**755 023**	**16 619**	**13.6%**
Percentage of GDP	*29.6%*	*27.2%*		*27.3%*	*28.3%*		
Expenditure							
Current payments	472 376	474 252	1 876	527 892	534 072	6 179	12.6%
of which:							
Debt-service cost	*55 268*	*57 129*	*1 861*	*71 358*	*66 570*	*-4 787*	*16.5%*
Transfers and subsidies	264 611	263 936	-675	284 016	282 269	-1 747	6.9%
Payments for capital assets	61 349	56 017	-5 332	68 163	59 781	-8 382	6.7%
Payments for financial assets	30 000	31 711	1 711	20 893	21 254	362	-33.0%
Contingency reserve	6 000	–	-6 000	6 000	–	-6 000	0.0%
Total expenditure	**834 336**	**825 917**	**-8 419**	**906 964**	**897 376**	**-9 588**	**8.7%**
Percentage of GDP	*33.7%*	*33.8%*		*33.6%*	*33.6%*		
Budget balance[3]	**-103 100**	**-161 076**	**-57 976**	**-168 560**	**-142 353**	**26 207**	**-11.6%**
Percentage of GDP	*-4.2%*	*-6.6%*	*-2.4%*	*-6.2%*	*-5.3%*	*0.9%*	
Gross domestic product	*2 474 214*	*2 442 593*		*2 699 888*	*2 666 894*		

1. *Payments to SACU partners in respect of a previous error in calculation of the 1969 agreement.*
2. *Includes provinces, social security funds and selected entities.*
3. *A positive number reflects a surplus and a negative number a deficit.*

The 2011 Budget adjusts the forward estimates tabled in the 2010 Budget for 2011/12 and 2012/13 to take account of changes in the economic environment and policy priorities, and adds projections for 2013/14. Table 4.6 illustrates the changes to revenue and expenditure forecasts since February 2010.

Table 4.6 Consolidated government budget medium-term estimates, 2011/12 – 2013/14

	2011/12			2012/13			2013/14
R million	2010 Forward estimate	2011 Budget	Change to baseline	2010 Forward estimate	2011 Budget	Change to baseline	2011 Budget
Revenue							
Tax revenue	721 477	741 620	20 143	818 298	827 310	9 012	927 960
Non-tax revenue	11 483	10 001	-1 482	12 379	11 540	-839	12 351
Less: SACU payments	-11 211	-21 763	-10 552	-22 781	-32 432	-9 651	-35 997
Other[1]	105 993	94 609	-11 384	114 382	102 296	-12 085	112 873
Budget revenue	**827 742**	**824 466**	**-3 276**	**922 278**	**908 714**	**-13 564**	**1 017 187**
Percentage of GDP	*27.9%*	*28.3%*		*28.0%*	*28.4%*		*28.8%*
Expenditure							
Current payments	580 140	587 702	7 562	623 715	635 953	12 237	684 638
of which:							
Debt-service cost	*88 463*	*76 579*	*-11 884*	*104 022*	*90 808*	*-13 214*	*104 036*
Transfers and subsidies	315 049	315 097	49	337 335	340 806	3 471	363 099
Payments for capital assets	69 418	71 608	2 191	73 567	73 410	-157	80 656
Payments for financial assets	754	767	13	5	8	3	4
Contingency reserve	12 000	4 090	-7 910	24 000	11 405	-12 595	23 375
Total expenditure	**977 361**	**979 265**	**1 904**	**1 058 622**	**1 061 582**	**2 960**	**1 151 773**
Percentage of GDP	*32.9%*	*33.6%*		*32.1%*	*33.2%*		*32.6%*
Budget balance[2]	**-149 619**	**-154 799**	**-5 180**	**-136 344**	**-152 868**	**-16 524**	**-134 586**
Percentage of GDP	*-5.0%*	*-5.3%*	*-0.3%*	*-4.1%*	*-4.8%*	*-0.6%*	*-3.8%*
Gross domestic product	*2 967 560*	*2 914 862*		*3 295 749*	*3 201 299*		*3 536 002*

1. *Includes provinces, social security funds and selected public entities.*
2. *A positive number reflects a surplus and a negative number a deficit.*

Public-sector borrowing requirement

The public-sector borrowing requirement represents the funds needed by the public sector to cover any deficit in financing its own activities.

Public-sector borrowing requirement narrows to 6.3 per cent of GDP by 2013/14

The public-sector borrowing requirement continues to be higher than borrowing by general government, reflecting borrowing by public enterprises to finance capital expenditure. The public-sector borrowing requirement is expected to be 10.5 per cent of GDP in 2010/11, declining to 6.3 per cent of GDP in 2013/14, largely as a result of improvement in the consolidated government budget balance.

The largest contributors to government's capital infrastructure programme are Eskom and Transnet. Borrowing by these enterprises will continue to support their capital programmes. Relatively few municipalities borrow funds to finance their capital budgets; those that do are scaling back their borrowing plans because they have reached or exceeded prudential limits.

Table 4.7 Public-sector borrowing requirement[1], 2007/08 – 2013/14

R million	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14
		Outcome		Revised estimate		Medium-term estimates	
National budget	**-19 352**	**27 158**	**167 518**	**143 361**	**159 066**	**161 713**	**148 715**
Extraordinary payments	776	4 284	671	802	150	–	–
Extraordinary receipts	-1 850	-8 203	-6 435	-3 148	-1 350	–	–
Borrowing requirement	**-20 426**	**23 238**	**161 754**	**141 015**	**157 866**	**161 713**	**148 715**
Social security funds	-8 614	-12 362	-10 624	-10 778	-10 388	-11 578	-11 208
Provinces	-1 062	8 927	189	1 587	-1 094	-3 138	-5 973
Extra-budgetary institutions	-6 155	3 802	3 993	8 183	7 215	5 870	3 052
Local authorities	4 571	13 298	16 723	7 470	9 105	8 152	8 641
General government borrowing	**-31 686**	**36 904**	**172 036**	**147 478**	**162 704**	**161 020**	**143 227**
Percentage of GDP	*-1.5%*	*1.6%*	*7.0%*	*5.5%*	*5.6%*	*5.0%*	*4.1%*
Non-financial public enterprises[2]	35 503	61 804	45 325	133 731	113 718	99 063	78 733
Percentage of GDP	*1.7%*	*2.7%*	*1.9%*	*5.0%*	*3.9%*	*3.1%*	*2.2%*
Public-sector borrowing requirement	**3 817**	**98 708**	**217 361**	**281 209**	**276 422**	**260 083**	**221 959**
Percentage of GDP	*0.2%*	*4.3%*	*8.9%*	*10.5%*	*9.5%*	*8.1%*	*6.3%*
Gross domestic product	*2 078 822*	*2 312 965*	*2 442 593*	*2 666 894*	*2 914 862*	*3 201 299*	*3 536 002*

1. A negative number reflects a surplus and a positive number a deficit.
2. 2010/11 – 2013/14 are based on National Treasury estimates.

Conclusion

South Africa responded to the recession by maintaining social expenditure and continuing to invest in infrastructure, providing a stimulus to economic activity. With a decline in revenue, government raised its borrowing level, bringing the fiscal position from a deficit of 1.2 per cent of GDP in 2008/09 to a deficit of 6.6 per cent of GDP in 2009/10. This was an appropriate response to the economic crisis.

As the economy recovers, government will reduce the budget deficit

As the economy recovers, government will reduce the budget deficit. By consolidating the fiscal position over the medium term, South Africa will be well placed to take advantage of growth opportunities.

5

Revenue trends and tax proposals

Overview

Raising sufficient revenue to support projected expenditure on government's economic and social priorities will require adjustments to the tax and expenditure framework over the medium to long term. This framework should contribute towards sustainable economic growth and job creation, while addressing the significant disparities in South African society.

Medium- to long-term spending priorities require adjustments to tax and expenditure framework

The 2009 recession sharply reduced the income available for public expenditure, with nominal tax revenues declining in 2009/10. Revenues have improved in 2010/11 and are expected to track modest real economic growth over the medium term. Recent data suggests a strong recovery in customs duties and value-added tax (VAT) revenues during 2010/11, but the recovery in corporate income tax revenue is lagging behind.

The 2011 Budget tax proposals are intended to broaden the tax base in support of inclusive growth. Businesses will receive tax breaks to support skills development and job creation, particularly for young workers. Various loopholes will be closed and tax equity will be improved by reforming the tax treatment of contributions to medical schemes and contributions to retirement funds. The new dividends tax will be implemented, replacing the secondary tax on companies. Consumption-related taxes, which also address environmental and health concerns, will be increased.

Businesses to receive tax breaks to support job creation and skills development

The main tax proposals include:

- Personal income tax relief of R8.1 billion
- A third rebate for individuals 75 years and older
- Conversion of medical tax deductions to tax credits

- Transfer duty relief
- Higher taxes on fuel
- Higher taxes on alcohol and tobacco
- Taxation of gambling winnings.

Budget revenue – revised estimates

Table 5.1 highlights budget estimates and revenue outcomes of the major tax instruments for 2009/10, and revised projected revenue outcomes for 2010/11. Tables 2 and 3 in Annexure B set out these trends in more detail.

Outcome for 2009/10 and revised estimates for 2010/11

2009/10 revenue of R598.7 billion was R26.4 billion lower than the prior year

Audited results show that tax revenue for 2009/10 of R598.7 billion was R26.4 billion or 4.2 per cent lower than for 2008/09. Lower corporate income tax (18.5 per cent down from the previous year), customs duties (13.6 per cent down) and VAT (4.1 per cent down) accounted for this overall decline.

Tax revenues recovered during 2010/11, with revised estimates R73.5 billion or 12.3 per cent higher than in 2009/10. This was the result of strong recoveries in personal income tax (11.1 per cent), VAT (22.6 per cent) and customs duties (34.9 per cent). However, nominal corporate income tax revenue declined by 1.8 per cent, an indication of the lag effect of the 2009 recession.

Tax expenditure statement

This *Budget Review* includes, for the first time, a tax expenditure statement. The statement, found in Annexure C, is a summary of tax revenues that were foregone as a result of various tax incentives to help achieve government’s social and economic objectives. Such forms of indirect expenditure are often hidden. Government is committed to transparency in the budget process, and publication of the tax expenditure statement promotes that objective.

The conservative estimate of total tax expenditure in 2008/09 was R78.1 billion, or 3.4 per cent of GDP.

Table 5.1 Budget estimates and revenue outcome, 2009/10 and 2010/11

	2009/10			2010/11			2009/10 – 2010/11
R million	Budget	Outcome	Deviation	Budget	Revised	Deviation	% change[1]
Taxes on income and profits	**389 040**	**359 045**	**-29 995**	**377 716**	**380 080**	**2 364**	***5.9%***
Persons and individuals	207 450	205 145	-2 305	224 676	228 000	3 324	*11.1%*
Companies	160 000	134 883	-25 117	133 650	132 500	-1 150	*-1.8%*
Secondary tax on companies	19 000	15 468	-3 532	16 500	16 500	–	*6.7%*
Tax on retirement funds	–	43	43	–	–	–	*0.0%*
Other taxes on income and profits [2]	2 590	3 506	916	2 890	3 080	190	*-12.1%*
Taxes on payroll and workforce	**7 750**	**7 805**	**55**	**8 424**	**8 420**	**-4**	***7.9%***
Taxes on property	**10 420**	**8 826**	**-1 594**	**9 960**	**9 365**	**-595**	***6.1%***
Domestic taxes on goods and services	**226 757**	**203 667**	**-23 090**	**230 880**	**247 540**	**16 660**	***21.5%***
Value-added tax	168 807	147 941	-20 866	164 000	181 335	17 335	*22.6%*
Specific excise duties	22 600	21 289	-1 311	24 250	22 900	-1 350	*7.6%*
Ad valorem excise duties	1 350	1 276	-74	1 200	1 900	700	*48.9%*
General fuel levy	30 090	28 833	-1 257	34 600	34 300	-300	*19.0%*
Other domestic taxes on goods and services[3]	3 910	4 328	418	6 830	7 105	275	*64.2%*
Taxes on international trade and transactions	**25 337**	**19 319**	**-6 018**	**20 850**	**26 790**	**5 940**	***38.7%***
Customs duties	24 635	19 577	-5 058	20 500	26 400	5 900	*34.9%*
Miscellaneous customs and excise receipts	702	-258	-960	350	390	40	*-251.0%*
Stamp duties and fees	**–**	**49**	**49**	**20**	**5**	**-15**	***-89.9%***
State miscellaneous revenue[4]	**–**	**-6**	**-6**	**–**	**–**	**–**	***0.0%***
Total tax revenue	**659 304**	**598 705**	**-60 599**	**647 850**	**672 200**	**24 350**	***12.3%***
Non-tax revenue[5]	11 602	8 889	-2 713	10 380	12 254	1 874	*37.9%*
of which:						–	*0.0%*
Mining royalties	–	–	–	*3 540*	*3 712*	*172*	*0.0%*
Mining leases and ownership	*325*	*633*	*308*	–	*900*	*900*	*42.2%*
Less: SACU payments	-27 915	-27 915	-0	-14 991	-14 991	–	*-46.3%*
Other adjustment[6]	–	–	–	–	-2 900	-2 900	*0.0%*
National budget revenue	**642 990**	**579 679**	**-63 312**	**643 239**	**666 563**	**23 324**	***15.0%***
Provinces, social security funds and selected public entities.	88 245	85 162	-3 083	95 165	88 460	-6 704	*3.9%*
Budget Revenue	**731 235**	**664 840**	**-66 395**	**738 404**	**755 023**	**16 619**	***13.6%***

1. *Percentage change 2009/10 outcome versus 2010/11 revised estimate.*
2. *Includes interest on overdue income tax and small business tax amnesty levy.*
3. *Includes air departure tax, plastic bags levy, electricity levy and Universal Service Fund.*
4. *Revenue received by SARS that could not be allocated to a specific tax instrument.*
5. *Includes mineral royalities, mining leases and departmental revenue.*
6. *Payments to Southern African Customs Union (SACU) partners for a previous error in calculation of the 1969 agreement.*

Revenue estimates and 2011/12 tax proposals

Table 5.2 sets out the estimates of revenue before consideration of the tax proposals for 2011/12.

Table 5.2 Estimates of revenue before tax proposals, 2010/11

R million	2010/11 Revised	2011/12 Before tax proposals	2010/11–2011/12 % change
Taxes on income and profits	**380 080**	**426 695**	***12.3%***
Persons and individuals	228 000	261 600	*14.7%*
Companies	132 500	143 665	*8.4%*
Secondary tax on companies	16 500	18 100	*9.7%*
Tax on retirement funds	–	–	*0.0%*
Other taxes on income and profits[1]	3 080	3 330	*8.1%*
Taxes on payroll and workforce	**8 420**	**9 150**	***8.7%***
Taxes on property	**9 365**	**10 340**	***10.4%***
Domestic taxes on goods and services	**247 540**	**269 225**	***8.8%***
Value-added tax	181 335	200 880	*10.8%*
Specific excise duties	22 900	23 300	*1.7%*
Ad valorem excise duties	1 900	2 080	*9.5%*
General fuel levy	34 300	35 000	*2.0%*
Electicity levy	290	5 380	
Other domesic taxes on goods and services[2]	415	2 585	*522.9%*
Taxes on international trade and transactions	**26 790**	**30 325**	***13.2%***
Customs duties	26 400	29 860	*13.1%*
Miscellaneous customs and excise receipts	390	465	*19.2%*
Stamp duties and fees	**5**	**–**	***-100.0%***
State miscellaneous revenue	**–**	**–**	***0.0%***
Total tax revenue	**672 200**	**745 735**	***10.9%***
Non-tax revenue[3]	12 254	10 001	*-18.4%*
of which			*0.0%*
Mineral royalties	*3 712*	*4 890*	*31.7%*
Mining leases and ownership	*900*	–	*-100.0%*
Less: SACU payments	-14 991	-21 763	*45.2%*
Other adjustment[4]	-2 900		*-100.0%*
National budget revenue	**666 563**	**733 973**	***10.1%***
Provinces, social security funds and selected public entities.	88 460	94 609	*7.0%*
Budget Revenue	**755 023**	**828 581**	***9.7%***

1. Includes interest on overdue income tax and small business tax amnesty levy.
2. Includes air departure tax, plastic bags levy and Universal Service Fund.
3. Includes mineral royalties, mining leases and departmental revenue. and sales of capital assets.
4. Payments to SACU partners for a previous error in calculation of the 1969 agreement.

Revenue recovery expected to continue in line with improved economic growth

Tax revenue should continue to improve during 2011/12 in line with improved economic growth prospects. The total tax revenue before tax proposals is expected to increase by 10.9 per cent.

Actual revenue collections and medium-term estimates

Table 5.3 sets out actual revenue collections for 2007/08 to 2009/10, the revised estimate for 2010/11 and the estimates for 2011/12 to 2013/14.

Without any tax changes, tax revenue as a percentage of GDP is expected to increase from 25.2 per cent in 2010/11 to 26.2 per cent in 2013/14.

Table 5.3 Budget revenue, 2007/08 – 2013/14

	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14
R million	**Outcome**			**Revised**	**Medium-term estimates**		
Taxes on income and profits[1]	332 058	383 483	359 045	380 080	418 345	469 709	533 561
Of which:							
Personal income tax	*168 774*	*195 115*	*205 145*	*228 000*	*252 750*	*292 710*	*337 970*
Coporate income tax	*140 120*	*165 378*	*134 883*	*132 500*	*144 165*	*161 350*	*178 230*
Taxes on payroll and w orkforce	6 331	7 327	7 805	8 420	9 150	9 610	10 130
Taxes on property	11 884	9 477	8 826	9 365	9 590	11 060	12 695
Domestic taxes on goods and services	194 690	201 416	203 667	247 540	274 210	302 880	333 170
of which:							
Value-added tax	*150 443*	*154 343*	*147 941*	*181 335*	*200 880*	*226 900*	*254 330*
Taxes on international trade and	27 082	22 852	19 319	26 790	30 325	34 050	38 404
Stamp duties and fees	557	572	49	5	–	–	–
State miscellaneous revenue[2]	212	-27	-6	–	–	–	–
Tax revenue	**572 815**	**625 100**	**598 705**	**672 200**	**741 620**	**827 310**	**927 960**
Non-tax revenue[3]	12 693	12 616	8 889	12 254	10 001	11 540	12 351
of which:							
Mineral and petroleum royalties	–	–	–	*3 712*	*4 890*	*5 150*	*5 430*
Less: SACU payments	-24 713	-28 921	-27 915	-14 991	-21 763	-32 432	-35 997
Other adjustment[4]				-2 900			
National budget revenue	**560 795**	**608 796**	**579 679**	**666 563**	**729 858**	**806 418**	**904 314**
Provinces, social security funds and selected public entities.	65 910	74 201	85 162	88 460	94 609	102 296	112 873
Budget Revenue	**626 705**	**682 997**	**664 840**	**755 023**	**824 466**	**908 714**	**1 017 187**
Tax revenue as a percentage of GDP	*27.6%*	*27.0%*	*24.5%*	*25.2%*	*25.4%*	*25.8%*	*26.2%*
Budget revenue as a	30.1%	29.5%	27.2%	28.3%	28.3%	28.4%	28.8%
GDP (R billion)	2 079	2 313	2 443	2 667	2 915	3 201	3 536
Tax/GDP multiplier	*1.05*	*0.81*	*-0.75*	*1.34*	*1.11*	*1.18*	*1.16*

1. Also includes secondary tax on companies and interest on overdue income tax and small business tax amnesty levy.

2. Revenue received by SARS in respect of taxation which could not be allocated to a specific tax instrument.

3. Includes mineral royalties, mining leases and departmental revenue.

4. Payments to SACU partners in respect of a previous error in calculation of the 1969 agreement.

Overview of tax proposals

Table 5.4 shows the expected impact of tax proposals on revenue collection in 2011/12, the net effect of which is to reduce the estimated total tax revenues by R4.1 billion

Income tax relief for individuals

Personal income tax relief of R8.1 billion

The Budget 2011 proposes direct tax relief to individuals of R8.1 billion through adjustments to personal income tax brackets and rebates. These adjustments compensate for the effects of inflation (fiscal drag).

In addition to the primary and secondary rebates, a third rebate of R2 000 per year is proposed for taxpayers 75 years and older, increasing the tax threshold for eligible individuals to R104 261.

Table 5.5 provides a summary of the 2011/12 income tax brackets, rates and rebates for individuals. Taxpayers with an annual taxable income of up to R270 000 will receive 50 per cent of this relief, those with an annual taxable income between R270 000 and R580 000 receive 33 per cent, those between R580 000 and R1 million receive 12 per cent and those with taxable income above R1 million receive 5 per cent.

Those with taxable income over R580 000 will account for 39 per cent of income tax revenue in 2011/12

Personal income tax provides the foundation for an equitable tax system. In 2011/12, 14.3 per cent of individual taxpayers – those with annual income between R270 000 and R580 000 – will account for 33 per cent of revenues from personal income taxes, and the 5.7 per cent of individuals with an annual taxable income above R580 000 will account for 39 per cent of personal income tax revenues.

Table 5.4 Impact of tax proposals on 2011/12 revenue

R million		Effect of tax proposals
Tax revenue		745 735
Non-tax revenue		10 001
Less: SACU payments		-21 763
National budget revenue		**733 973**
Provinces, social security funds and selected public entities.		94 609
Budget revenue (before tax proposals)		**828 581**
Budget 2011/12 proposals:		**-4 115**
Taxes on individuals and companies	**-8 350**	
Personal income tax	-8 850	
Adjustment in personal tax rate structure	*-8 100*	
Adjustment in monetary thresholds	*-750*	
Business taxes	500	
Closure of dividend cession schemes	*500*	
Taxes on property	**-750**	
Adjustment in transfer duties	-750	
Indirect taxes	**4 985**	
Increase in general fuel levy	1 900	
Increase in excise duties on tobacco	1 785	
Increase in Ad valorem excise duties	150	
Increase in electricity levy	1 150	
Budget revenue (after tax proposals)		**824 466**

Medical deductions and conversion to medical tax credits

Increases in monthly monetary caps for contributions to medical schemes

Taxpayer contributions to medical schemes up to a specified monetary threshold are tax deductible, as are qualifying out-of-pocket medical expenses. The 2011 Budget proposes to increase the monthly monetary threshold for tax-deductible contributions to medical schemes from R670 to R720 for the first two beneficiaries, and from R410 to R440 for each additional beneficiary. This will become effective on 1 March 2011.

The monthly deductions for contributions to medical schemes and for qualifying out-of-pocket medical expenses will be converted into tax credits effective 1 March 2012. A tax credit provides for more equitable tax relief, as the relative value of the relief does not increase as the marginal tax rate of the individual increases, as is currently the case. A discussion document on these credits will be published by the end of March 2011.

Table 5.5 Personal income tax rate and bracket adjustments, 2010/11 – 2011/12

2010/11		2011/12	
Taxable income (R)	**Rates of tax**	**Taxable income (R)**	**Rates of tax**
R0 - R140 000	18% of each R1	R0 - R150 000	18% of each R1
R140 001 - R221 000	R25 200 + 25% of the amount above R140 000	R150 001 - R235 000	R27 000 + 25% of the amount above R150 000
R221 001 - R305 000	R45 450 + 30% of the amount above R221 000	R235 001 - R325 000	R48 250 + 30% of the amount above R235 000
R305 001 - R431 000	R70 650 + 35% of the amount above R305 000	R325 001 - R455 000	R75 250 + 35% of the amount above R325 000
R431 001 - R552 000	R114 750 + 38% of the amount above R431 000	R455 001 - R580 000	R120 750 + 38% of the amount above R455 000
R552 001 and above	R160 730 + 40% of the amount above R552 000	R580 001	R168 250 + 40% of the amount above R580 000
Rebates		**Rebates**	
Primary	R10 260	Primary	R10 755
Secondary	R5 675	Secondary	R6 012
		Third rebate	R2 000
Tax threshold		**Tax threshold**	
Below age 65	R57 000	Below age 65	R59 750
Age 65 and over	R88 528	Age 65 and over	R93 150
		Age 75 and over	R104 261

National health insurance

Payroll tax, higher VAT and a surcharge on taxable income are under consideration to finance NHI

Government expects that national health insurance (NHI) will be phased in over 14 years. While initial allocations are made in the 2011 Budget, the NHI system will require funding over and above current revenues allocated to public health. Preliminary analysis indicates that the phasing in of a payroll tax (payable by employers), an increase in the VAT rate and a surcharge on individuals' taxable income could be considered as funding options. The feasibility and practicality of co-payments or user charges will also be explored. Announcements about specific funding instruments will be made in the 2012 Budget.

Savings

Interest income is not taxed up to a certain threshold. As from 1 March 2011, government will increase the tax-free interest-income annual threshold from R22 300 to R22 800 for individuals below 65 years, and from R32 000 to R33 000 for individuals 65 years and over. The foreign interest-income threshold will remain at R3 700.

Incentives to encourage savings for housing and higher education

Several countries use tax incentives to encourage people to save towards specific goals such as education, healthcare, housing or retirement, or to promote general savings. Government will explore two incentivised savings schemes – one for housing (deposit for first-time homeowners) and another for higher education – as alternatives to tax-free interest-income thresholds.

The possibility of a more consistent tax treatment of all forms of income from capital, such as interest, dividends and capital gains, will also be considered.

Social security and retirement reforms

Tax treatment of contributions to retirement funds

Reforms of the tax treatment of contributions to retirement funds

Taxpayers are allowed income tax deductions for contributions to pension and retirement annuity funds. In addition, employers may contribute to retirement funds on behalf of employees. These contributions by employers are not currently taxed in the hands of employees. Several changes are proposed to improve tax administration and promote greater equity in the income tax system. From 1 March 2012:

- An employer's contribution on behalf of an employee will be deemed a taxable fringe benefit in the hands of the employee. Individuals will be allowed to deduct up to 22.5 per cent of their taxable income for contributions to pension, provident and retirement annuity funds.
- To ensure greater equity, two thresholds will be established – a minimum annual deduction of R12 000 and an annual maximum of R200 000.
- The base on which contributions to retirement funds and other social security taxes is calculated will be streamlined.

To protect workers' savings, government proposes to subject lump-sum withdrawals from provident funds to the one-third limit applying to pension and retirement annuities. The implementation date of any changes in the rules governing provident funds will be subject to thorough consultation with trade unions and other interested parties, and vested rights will be protected.

Enhanced competition for provision of living annuities

Government will broaden the list of entities that can offer living annuities

Living annuities can only be provided by long-term insurers. To encourage competition, government proposes to broaden the list of service providers allowed to provide these annuities to include collective investment schemes and the National Treasury's retail savings bond scheme.

Review tax treatment of risk benefits

To ensure equity, the tax system should not treat lump-sum payments more favourably than annuity payments. Government proposes that any compensation from the Road Accident Fund and its no-fault successor, whether as a lump-sum payment or an annuity, be exempted from income tax. At the same time, alignment of the tax treatment of risk benefits paid by private-sector funds will be investigated.

Taxation of lump sum benefits upon retirement

As from 1 March 2011, government will increase the tax-free lump sum benefit upon retirement from R300 000 to R315 000. The revised tax table appears in Table C.7 of Annexure C.

Adjustment of monetary thresholds

Proposed increase in various monetary thresholds

In addition to the measures mentioned above, government proposes to increase capital gains exclusion amounts as follows as from 1 March 2011:

- For individuals and special trusts from R17 500 to R20 000 annually
- On death from R120 000 to R200 000
- On disposal of a small business when a person is over 55 years old from R750 000 to R900 000

The annual trading income exemption for public benefit organisations will increase from R150 000 to R200 000, and for recreational clubs from R100 000 to R120 000.

Gambling

All winnings over R25 000 to be subject to 15 per cent withholding tax

Government proposes that with effect from 1 April 2012 all gambling winnings above R25 000, including those from the National Lottery, be subject to a final 15 per cent withholding tax. Similar gambling taxes exist in India, the Netherlands and the United States.

Business taxes

Dividends tax

Introduction of dividends tax on 1 April 2012

The dividends tax will take effect on 1 April 2012, replacing the secondary tax on companies. The introduction of the tax should correct the impression that a tax on dividends is another tax on businesses: legally and economically, it will be a tax on individuals and non-resident shareholders.

Closure of dividend schemes

Several dividend schemes undermine the tax base. One method involves the use of dividend cessions, where taxpayers effectively purchase tax-free dividends without any stake in the underlying shares. Another scheme involves the receipt of dividends from shares in which the taxpayer has no meaningful economic risk (e.g. has an offsetting derivative position). Some arrangements make use of preference shares that generate allegedly tax-free dividends, while the dividends are indirectly generated from interest-yielding debt. All these schemes will be closed by treating the dividends at issue as ordinary revenue.

Internal company restructuring

Adjustments to tax rules to ensure appropriate tax relief for debtors in the event of debt cancellations

The Income Tax Act (1962) provides special rules for debt cancellation and similar adjustments. Government will consider exempting otherwise taxable gains or ordinary revenue imposed on the debtor if the debt is cancelled or reduced. Relief will be limited to insolvent debtors to ensure that this does not give rise to tax avoidance.

Venture capital company

Many small and medium-sized businesses find it difficult to access equity finance. This led government to introduce the concept of a venture capital company into the Income Tax Act. The response to this vehicle has been poor and the provisions will be reviewed.

Islamic finance

The 2010 Budget announced that the taxation of Islamic financial products would be aligned with conventional financial instruments. Provisions were introduced to cover several instruments. This year the rules will address *ijara* products, which act like commercial finance leases. Amendments to legislation will facilitate the issue of Islamic-compliant government bonds.

Research and development tax incentive

Proposed pre-approval process for research and development tax incentive

The research and development tax incentive is intended to encourage innovation and job creation. Government proposes to streamline the current incentive, introducing an approval process by the Department of Science and Technology before a taxpayer can claim this incentive. This should limit opportunities for retrospective reclassification of spending.

Promoting skills development and job creation

Learnership tax incentive

Five-year extension of learnership tax incentive pending outcome of review

The learnership tax incentive, designed to support youth employment, will expire in September 2011. The tax expenditure associated with this incentive is estimated to have amounted to R324 million in 2007/08, but its effectiveness is difficult to assess. Government proposes to extend the incentive for five years, subject to an analysis of its effectiveness by businesses, sector and training authorities, and the Department of Higher Education and Training. The review will take place during 2011.

Youth employment subsidy

To support job creation, a youth employment subsidy in the form of a tax credit costing R5 billion over three years will be introduced. It will be administered by the South African Revenue Service (SARS) through the PAYE system to limit abuse, ensure maximum liquidity and ease business compliance.

Industrial development zones

To support the objectives of the industrial policy action plan and the New Growth Path, businesses making greenfield and/or brownfield investments qualify for tax relief. Greenfield investments in industrial development zones (IDZs) qualify for additional relief. Government will consider expanding incentives for labour-intensive projects in IDZs.

Additional tax relief for businesses making greenfield investments in IDZs

International taxation

Gateway into Africa – headquarter regime

During 2010, tax rules were amended to enable regional investments to flow through South Africa without being taxed. These measures were intended to encourage the development of regional investment banks and holding companies in South Africa. However, current rules could lead to double taxation. There are also concerns about the manner of imposition of residence-based taxation. These concerns will be reviewed.

Refinement of controlled foreign company legislation

The main purpose of controlled foreign company rules is to prevent South African residents from shifting passive income offshore. Some provisions are overly complex and can interfere with normal business conduct, while others create unintended loopholes. Adjustments will focus the rules without compromising their purpose.

Controlled foreign company rules to be made more targeted

Transfer duty

Government proposes to increase the transfer duty exemption threshold from R500 000 to R600 000. A rate of 3 per cent will be applicable to the value from R600 001 to R1 000 000; an amount of R12 000 plus 5 per cent to the value between R1.0 and R1.5 million; and an amount of R37 000 plus 8 per cent to amounts above R1.5 million. This revised rate structure will apply to properties acquired under purchase agreements concluded on or after 23 February 2011. It will also be applicable to legal persons (close corporations, companies and trusts).

Transfer duty exemption threshold to increase from R500 000 to R600 000

Excise duties on tobacco and alcohol

The proposed adjustments to alcohol and tobacco taxes are as follows:

- The current indirect tax burden (excise duties plus VAT) as a percentage of the weighted average retail selling price for wine, clear beer and spirits at 23, 33, and 43 per cent respectively will be maintained for 2011/12. Excise duties on alcoholic beverages will be increased by between 4.5 and 10.0 per cent as shown in Table 5.6.
- The targeted total tax burden on tobacco products (excise duties plus VAT) is 52 per cent. Accordingly, the 2011 Budget proposes a 6 per cent increase on the excise duty for cigars, a 9 per cent increase for cigarettes, a 8.2 per cent increase for cigarette tobacco and a 10.3 per cent increase for pipe tobacco.

In the 2010 Budget, the Minister of Finance announced a review of the excise duty structure for alcoholic beverages. A discussion document will be published for public comment in July 2011.

Ad valorem excise duties

Excise tax rate on motor vehicles increases from 20 per cent to 25 per cent

Passenger cars and light commercial vehicles are subject to a "luxury" excise tax that increases with the price of the vehicle. Government proposes to increase the maximum nominal ad valorem excise tax rate on these vehicles from 20 per cent to 25 per cent.

Ad valorem excise duties on monitors were abolished in 2004 based on the assumption that they were used as computer screens. However, some monitors are also used as televisions, which are subject to ad valorem tax. Ad valorem excise duties on monitors will be reinstated at a flat rate of 7 per cent. These amendments will take effect on 1 April 2011.

Table 5.6 Changes in specific excise duties, 2011/12

Product	Current excise duty rate	Proposed excise duty rate	Percentage change Nominal	Real
Malt beer	R50.20 / litre of absolute alcohol	R53.97 / litre of absolute alcohol	*7.51%*	*2.71%*
Traditional African beer	7.82c / litre	7.82c / litre	*0.00%*	*-4.80%*
Traditional African beer pow der	34.70c / kg	34.70c / kg	*0.00%*	*-4.80%*
Unfortified w ine	R2.14 / litre	R2.32 / litre	*8.41%*	*3.61%*
Fortified w ine	R4.03 / litre	R4.33 / litre	*7.44%*	*2.64%*
Sparkling w ine	R6.67 / litre	R6.97 / litre	*4.50%*	*-0.30%*
Ciders and alcoholic fruit beverages	R2.52 / litre (85.69c / average 340ml can)	R2.71 / litre (92.14c / average 340ml can)	*7.54%*	*2.74%*
Spirits	R84.57 / litre of absolute alcohol	R93.03 / litre of absolute alcohol	*10.00%*	*5.20%*
Cigarettes	R8.94/ 20 cigarettes	R9.74/ 20 cigarettes	*8.95%*	*4.15%*
Cigarette tobacco	R9.73/ 50g	R10.53/ 50g	*8.18%*	*3.38%*
Pipe tobacco	R2.70/ 25g	R2.98/ 25g	*10.25%*	*5.45%*
Cigars	R47.66 / 23g	R50.52 / 23g	*6.00%*	*1.20%*

Fuel taxes

Fuel tax levy to increase by10 cents per litre

Government proposes to increase the general fuel levy by 10c/l on both petrol and diesel effective from 6 April 2011. The RAF levy will be increased by 8c/l to 80c/l on the same date. Table 5.7 provides a summary of the proposed fuel tax rates for 2011/12.

Table 5.7 Total combined fuel taxes on petrol and diesel, 2009/10 – 2011/12

	2009/10		2010/11		2011/12	
c / litre	93 Octane petrol	Diesel	93 Octane petrol	Diesel	93 Octane petrol	Diesel
General fuel levy	150.00	135.00	167.50	152.50	177.50	162.50
Road Accident Fund levy	64.00	64.00	72.00	72.00	80.00	80.00
Customs and excise levy	4.00	4.00	4.00	4.00	4.00	4.00
Illuminating paraffin marker	0.00	0.01	0.00	0.01	0.00	0.01
Total	**218.00**	**203.01**	**243.50**	**228.51**	**261.50**	**246.51**
Pump price: Gauteng (as in February)[1]	643.00	649.35	785.00	701.85	884.00	814.05
Taxes as % of pump price	*33.9%*	*31.3%*	*31.0%*	*32.6%*	*29.6%*	*30.3%*

1. Diesel (0.05% sulphur) wholesale price (retail price not regulated.)

Environmental taxation

Carbon tax discussion paper

Work on a proposed carbon emission tax is under way

As part of its response to climate change, government is considering a carbon tax. A discussion paper entitled *Reducing Greenhouse Gas Emissions: The Carbon Tax Option* was published for public comment in December 2010. Comments are due by the end of February 2011. The design features of a proposed tax and a schedule for its introduction will be announced in the 2012 Budget.

Electricity levy

Increase in the electricity levy

Government proposes to increase the levy applied to electricity generated from non-renewable and nuclear energy sources by 0.5c/kWh to 2.5c/kWh from 1 April 2011. Some of this revenue will be set aside to fund the rehabilitation of roads damaged as a result of the haulage of coal for electricity generation. The increase should have no impact on electricity tariffs, because it has already been taken into account in the National Energy Regulator tariff structure.

International air passenger departure tax

From 1 October 2011, the air passenger departure tax on flights to Southern African Customs Union member states and other international destinations will increase from R80 and R150 per passenger respectively to R100 and R190 per passenger.

Tax administration

Review of the turnover tax for micro businesses

Turnover tax for micro businesses adjusted to encourage participation

The turnover tax was implemented in 2009 to broaden the tax base and simplify tax for micro businesses with annual turnover up to R1 million. Only about 7 700 businesses have registered for this approach, of which 88 per cent were previously registered for income tax. The tax rates will be adjusted from 1 March 2011 so that a micro business only becomes liable to pay turnover tax if its turnover exceeds R150 000 (currently R100 000) a year.

Micro businesses that register for VAT will no longer be barred from registering for turnover tax

From 1 March 2012, micro businesses that register for VAT will no longer be barred from registering for turnover tax. The three-year bar on voluntary deregistration from the turnover tax will also be lifted. SARS will be empowered to register unregistered micro businesses that it detects for the turnover tax.

Tax payments by individuals with more than one source of income

The Minister of Finance has received several letters from widows and widowers who have experienced increases in their tax liability subsequent to the death of a spouse. This happens in cases where the surviving spouse receives a pension from the pension fund of the deceased, from which little or no PAYE is deducted. SARS will contact such taxpayers and advise them to ask their insurance company or employer to deduct additional taxes.

Voluntary disclosure programme

Voluntary disclosure programme will remain open until 31 October 2011

To encourage taxpayers to come forward to regularise their tax affairs without the imposition of additional tax, penalties and interest, the voluntary disclosure programme that began in November 2010 will remain open until 31 October 2011. More than 1 200 applicants have already come forward under the programme.

Tax Administration Bill

The Tax Administration Bill, which incorporates several generic administrative provisions from different tax acts into one piece of legislation, will be introduced in the National Assembly during 2011.

Customs

SARS has launched its customs modernisation programme. Customs codes aligned with procedures prescribed in the Kyoto Convention have been introduced, and during 2011 automated inspection services and electronic acquittals will be implemented. Later this year, two bills will be introduced to Parliament to provide an internationally aligned legal framework that will support customs modernisation.

Audit

SARS plans to make greater use of data provided by credit bureaus to build detailed taxpayer profiles and identify non-compliance. SARS is also extending its cooperation with other tax administrations in the areas of information exchange, skills transfer and audit.

Tax policy research projects

The following tax policy research projects are under way:

- Taxation of financial derivatives.

- Taxation of long-term insurers.
- Housing tax incentive for developers. To increase the supply of affordable housing (below R300 000), the feasibility of an income tax credit for developers will be explored.
- Provincial motor vehicle licence fees. Minimum national standards to include an environmental tax component in provincial licence fee structures will be considered.
- VAT treatment of public passenger transport services. The VAT treatment of public passenger transport, rail, bus and taxi, will be reviewed with the objective to facilitate higher levels of investments in passenger transport infrastructure.
- VAT and educational accommodation. VAT treatment and apportionment rules concerning educational institutions that provide contract research and student accommodation will be reviewed.
- Estate duty. The effectiveness of estate duty (20 per cent on the net value of estates in excess of R3.5 million) is being reviewed, with several options under consideration.
- User charges and other fees. Mechanisms for the setting of user charges and administrative fees will be reviewed. The setting of such fees should be transparent and subject to public consultation, particularly where these are not regulated by an independent agency.

This page has been left blank intentionally.