Budget Watch: Progression & Stability

KPMG's 2018 Budget Summary

Finance Minister Malusi Gigaba delivered his maiden National Budget address on 21 February 2018. Over the last few years we have predicted an increase in the VAT rate, and the key tax proposal in this Budget was that, for the first time since 1993, South Africa will increase its VAT rate.

Key highlights

National Treasury aims to bring in an additional R36 billion of tax revenue through the following key tax proposals:

- An increase in the VAT rate from 14% to 15% (an estimated R22.9 billion of additional tax revenue).
- A below-inflation increase in the personal income tax rebates and brackets, with greater relief for those in the lower income tax brackets (an estimated R6.8 billion of additional tax revenue).
- An increase in the ad-valorem excise duty rate on luxury goods from 7% to 9% (an estimated R1 billion of additional tax revenue).
- A higher estate duty tax rate of 25% for estates greater than R30 million (an estimated R0.2 billion of additional tax revenue).
- A higher donations tax rate of 25% for donations exceeding R30 million in one tax year.
- Increases in fuel levies and sin taxes (an estimated R2.5 billion of additional tax revenue).

Value-Added Tax proposals

- ***VAT rate***: The VAT rate increase from 14% to 15% will be effective 1 April 2018.
- ***Electronic fiscal devices***: SARS will release a discussion paper on the potential use of electronic fiscal devices, also known as electronic cash registers, to help revenue administration by monitoring business transactions.
- ***Foreign electronic service entities***: Draft regulations broadening the ambit of foreign electronic services subject to VAT have been issued and will become effective on 1 October 2018.
- ***Debts sold or ceded:*** A VAT vendor is permitted to claim a deduction for VAT on taxable supplies that were provided on credit, and later have to be written off as irrecoverable. Where the debts are sold or ceded on a non-recourse basis, a double VAT deduction is made in some circumstances by both the transferor and transferee of such debt. An amendment will be made to avoid a double VAT deduction in these circumstances.
- ***Correction of tax invoices***: The proposed amendment seeks to facilitate the correction of tax invoices which contain incorrect information – in other words, a vendor will be able to cancel the incorrect invoice and reissue the tax invoice with the corrected information.
- ***Credit notes for supplies after sale of an enterprise as a going concern:*** It is proposed that a purchaser of an enterprise be allowed to issue credit notes in respect of goods that were supplied by the seller but subsequently returned to the purchaser.
- ***Separate treatment of branches or divisions of a corporate entity for VAT debt-collection purposes:*** An amendment is proposed to provide legal certainty that the provisions for collecting VAT debt will apply across all branches and divisions of a corporate entity, despite such branches or divisions being separately registered as VAT enterprises.
- ***Extension of joint and several liability for VAT to members of a joint venture:*** An amendment is proposed to provide legal certainty that the members of a joint venture may also be jointly and severally liable for the VAT debts of that venture.

General income tax proposals

- ***Collateral lending arrangements***: It is proposed that the legislation be amended to prevent foreign shareholders from reducing the applicable dividends tax rate to zero in respect of listed shares acquired in a collateral lending arrangement with a South African resident company.
- ***Excessive debt financing***: A discussion document, for public consultation, will be issued regarding potential tax abuse of interest-bearing finance structures.
- ***Share buy-backs and dividend stripping:*** It is proposed to review the legislation relating to share buy-backs and dividend stripping, to ensure legitimate transactions are not negatively impacted.
- ***Doubtful debts allowance***: In order to avoid uncertainty, the criteria for determining the doubtful debt allowance will be included in the tax legislation.
- ***Electronic communications cabling***: Due to recent capital outlays on fiber optic cabling by the telecommunications industry, government will consider accelerating the existing 15-year write-off period, and clarify who is entitled to the allowance, given the complexities of ownership and right of use of such cables.

- ***Amendments to tax incentives***:
  - *Employment tax incentive (ETI)*: While the ETI has had a positive impact on smaller firms, it has had a low or negative impact on larger firms. This will be reviewed before the ETI's expiry on 28 February 2019.
  - *Special Economic Zones (SEZs):* Six SEZs will be approved to encourage investment in manufacturing. The benefits to companies setting up business in a SEZ will include a lower corporate tax rate and an extension of the ETI to employees of all ages.
  - *Research and Development (R&D)*: Legislative complexities in respect of the current section 11D R&D incentive programme will be reviewed by the Department of Trade and Industry to ensure applications are reviewed and approved timeously.
  - *Automotive Production Development Programme (APDP)***:** A review of the incentive programme will be performed to ensure alignment with policy objectives, and the success of the programme given the costs incurred.
  - *Venture capital regime*: Despite an uptake of the incentive with a positive effect on the growth of small businesses, further legislative tweaks will be considered in order to further increase the appeal of this incentive.
  - *Industrial policy project incentive*: The industrial policy project incentive has been extended from 31 December 2017 to 31 March 2020.

Cross-border income tax proposals

- ***Controlled foreign companies (CFCs):***
  - *High tax exemption***:** As a result of a global trend towards a lower corporate tax rate, the current exemption from taxation for CFCs operating in countries with a tax rate of more than 75% of what the South African tax rate would be, will be reviewed. A reduction in the 75% threshold may be warranted.
  - *Revisiting distributions from foreign trusts and foundations:* Linking in to the changes to CFC rules in 2017, legislation was proposed to render distributions by foreign trusts fully taxable in the hands of the recipient beneficiary. This will again be considered in the 2018 legislative cycle.
- ***Exemption in respect of international shipping income***: Income derived from the conveyance of passengers or goods by a *South African ship* that is engaged in international traffic is generally exempt from income tax. It is proposed that the exemption be extended to also apply, under certain circumstances, where a South African shipping company temporarily uses a ship that is registered in a jurisdiction other than South Africa.
- ***Foreign denominated receivables disposed of at a loss:*** The legislation will be amended to clarify the tax treatment of foreign exchange gains or losses recognised in respect of a foreign denominated receivable which is disposed of at a loss due to market forces.
- ***Interest withholding tax***: In respect of interest paid to foreign beneficiaries of a trust, it will be clarified who is responsible for withholding the tax, once vesting of the interest in the foreign beneficiary occurs.

Income tax proposals specific to financial services

- ***Short term insurers:*** It is proposed that tax legislation applicable to short-term insurers, which currently apply only to residents, be extended to apply to non-residents operating in South Africa. This is to align with the Insurance Act (2017) which allows foreign reinsurers to operate businesses in South Africa.
- ***Long-term insurers*:** The applicable effective date of the tax legislation associated with the introduction of the solvency assessment and management framework, will be amended to also apply to the risk policy fund.
- ***Collective investment schemes (CISs)***: Amounts (other than capital amounts) that accrue to any CIS (other than a CIS in property) are taxable in the CIS, unless distributed to participatory interest holders within 12 months of accrual. The current rules are open to abuse, as it is not always clear when profits are capital in nature. The rules are to be clarified to provide certainty on the treatment of revenue profits in this context.

Individuals and employment tax proposals

- ***Estate duty rate increase***: With effect from 1 March 2018, the estate duty rate will increase from 20% to 25% of the taxable value of a deceased estate that exceeds R30 million.
- ***Donations tax rate increase***: Donations in excess of R30 million in one tax year will be taxed at 25%, instead of 20%, effective 1 March 2018.
- ***Medical tax credits:***
  - *Increase:* Medical tax credits will increase from R303 to R310 per month for the first two beneficiaries, and from R204 to R209 per month for the remaining beneficiaries.
  - *Splitting of medical fees credits*: A taxpayer qualifies for medical tax credits, if he/she pays medical aid contributions or expenses. This is effectively a rebate against his/her tax liability. Some taxpayers also contribute to the medical aid contributions or costs of another person, such as an elderly parent, and are arguably benefitting excessively from the rebate. To curb this, where medical contributions or costs are shared among certain taxpayers, it is proposed that the medical tax credit is apportioned between the various contributors.
- ***Personal income tax:***
  - The personal income tax tables have been adjusted by increasing the bottom three tax brackets below inflation. The top four tax brackets have not changed and no relief is therefore provided for fiscal drag.
  - The rebates have increased as follows:
    - Primary R13 635 to R14 067
    - Secondary R7 479 to R7 713
    - Tertiary R2 493 to R2 574
  - The tax thresholds have increased as follows:
    - Below age 65
      R75 750 to R78 150
    - Age 65 and over
      R117 300 to R121 000
    - Age 75 and over
      R131 150 to R135 300
- ***Low-cost housing loans at preferential rates***: Fringe benefit tax will not be imposed on housing loans up to R450 000, granted at preferential interest rates, by employers to employees who earn remuneration of less than R250 000.
- ***Retirement reforms:***
  - *Contributions to retirement funds outside South Africa:* Retirement benefits from a foreign fund, in respect of employment rendered outside South Africa, is currently exempt. This will be reviewed to ensure deductible contributions are only allowed where benefits are taxable.
  - *Allowing transfers to pension and provident preservation funds after retirement:* The tax treatment of transfers by individuals after their retirement to pension preservation and provident preservation funds, are to be legislated. The 2017 legislative amendments already provide for post-retirement transfers to retirement annuity funds.

- *Rectifying anomalies on the transfer of retirement funds:* The transfer of amounts between funds at the same employer has inadvertently led to a tax liability for members due to the current wording of the legislation.
  The legislation will be amended retrospectively to correct these unintended tax liabilities.
- *Tax treatment of retirement fund withdrawals upon emigration*: When an individual formally emigrates from South Africa, he/she is able to withdraw the full value of his/her retirement annuity (after payment of applicable taxes). It is proposed that the tax treatment for other types of retirement fund withdrawals on emigration be aligned.

Administrative proposals

- ***Dividends tax returns***: The legislation will be amended to provide that no dividend tax return needs to be submitted by a person/entity receiving an exempt dividend.
- ***Notification of audit***: In a welcome move, it has been proposed that SARS will be obliged to notify taxpayers of the start of a tax audit.

Customs and excise duty proposals

- ***Customs and excise rate increases:***
  - *Specific excise duties:* Effective 21 February 2018, specific customs and excise duties are increased. On most alcoholic beverages the rate increased by between 6% and 10%, (excluding traditional African beer and beer powder, which remain unchanged). The rate of duty on tobacco products and cigars increased by 8.5%.
  - *General Fuel Levy and Road Accident Fund Levy:* The General Fuel Levy is increased by 22c/li to 337c/li and 322c/li for petrol and diesel, respectively. The Road Accident Fund Levy will increase by 30c/li to 193c/li. These increases will take effect on 4 April 2018.
  - *Ad valorem excise duties:* Government proposes an increase in the *ad valorem* excise duties on certain luxury goods. Proposals include a maximum increase in *ad valorem* excise duty for motor vehicles from 25% to 30%. Inclusion of smart phones in the classification of cellular telephones is also proposed to attract *ad valorem* excise duties. The *ad valorem* excise duty rate, currently on 5% and 7%, will be increased to 7% and 9%. Government will also consult on a proposal to replace the flat rate for cell phones with a progressive rate structure, based on the value of the phone.
- ***"Forestalling":*** Government proposes to introduce amendments to prevent "forestalling", a practice through which abnormal volumes of products are moved from warehouses into the market to avoid increases in excise duty rates.
- ***"Fiscal markers":*** Government proposes to introduce amendments to extend the use of "fiscal markers", which are required under the tracking and tracing obligations of the World Health Organisation's Protocol to Eliminate Illicit Trade in Tobacco Products.
- ***Diesel refund system:*** Following a comprehensive review of the administration of the diesel refund system, which requires delinking the diesel refund from the VAT system and the creation of a stand-alone diesel refund administration, National Treasury and SARS will engage with affected industries and other role players as a next step in the reform process. The legislative amendments giving effect to the separation will be developed following public consultations.

Environmental tax proposals

- ***Carbon Tax:*** The Carbon Tax is proposed to be implemented from 1 January 2019.
- ***Carbon Dioxide Emissions Tax:*** From 1 April 2018, the carbon dioxide emissions tax is R110 for every gram above 120gCO^2/km for passenger vehicles and R150 for every gram above 175gCO^2/km for double cabs.
- ***Plastic Bag Levy:*** Effective 1 April 2018, the environmental levy payable in respect of plastic bags (shopping bags) is 12 cents per bag.
- ***Electric Filament Lamps Levy:*** From 1 April 2018, the environmental levy payable in respect of electric filament lamps is R8 per globe.

- ***Acid Mine Drainage Levy:*** Government will publish a discussion document outlining design options for the proposed acid mine drainage levy to charge polluters for the cost of environmental damages, and to help fund the treatment of acid mine water.
- ***Environmental fiscal reform policy:*** An environmental fiscal reform policy brief is proposed by government to examine fiscal and regulatory options to improve water resource management, mitigate the emission of pollutants and reduce waste.
- ***Health Promotion Levy:*** From 1 April 2018, a health promotion levy which taxes sugary beverages will be implemented. Government will publish a policy brief on the use of taxes to encourage healthy choices.

Exchange control proposals

- ***Reforming loop structures:*** Outward investments that involve the creation of *unintended* loop structures require prior approval from the Financial Surveillance Department (**FSD**). As an exception, South African companies are, on application to their Authorised Dealer, permitted to acquire 10% to 20% participation rights in a foreign target entity, which in turn hold investments (including loans) in a CMA country. Thus, this dispensation does *not* apply to foreign direct investments where South African companies collectively hold more than 20% participation rights in the foreign entity. This 20% threshold is to be increased to 40% for *bona fide* business investment, growth and expansion transactions. The minimum 10% requirement is to be abolished.
- ***Treasury management companies:*** South African entities may establish one subsidiary as a holding company for its offshore operations, subject to certain conditions. These conditions are to be relaxed and allowable transfers by parent companies to holding entities will be increased from R2 billion to R3 billion for listed companies, and from R1 billion to R2 billion for unlisted companies.
- ***Prudential limit:*** To increase investment in diverse assets, the offshore limit for funds under management by institutional investors is increased by 5% for all categories, including the African allowance.
- ***Approval of cross-border transactions:*** To support cross-border investment and increase transparency, a policy framework for the review and approval of complex cross-border transactions will be released later this year.
- ***Inward listings:*** The inward listing policy is aimed at deepening South Africa's capital markets, but may be creating distortions. A comprehensive inward listings review paper will be released in 2018.
- ***Cryptocurrencies:*** The Reserve Bank, together with the other domestic financial sector regulators, intends to publish a position paper in 2018 on the evolving uses of cryptocurrencies.

Contact Us

Johannesburg and Pretoria:

Mohammed Jada
Head of Corporate Tax
T: +27 82 719 5531
E: mohammed.jada@kpmg.co.za

Andre Meyburgh
Head of Indirect Tax
T: +27 82 851 6587
E: andre.meyburgh@kpmg.co.za

Venter Labuschagne
Head of Customs and Excise
T: +27 83 677 7744
E: venter.labuschagne@kpmg.co.za

Johan Heydenrych
Head of Tax Management Services
T: +27 82 719 2468
E: johan.heydenrych@kpmg.co.za

Natasha Vaidanis
Head of International Tax and Transfer Pricing
T: +27 82 458 1043
E: natasha.vaidanis@kpmg.co.za

Carolyn Chambers
Head of Global Mobility Services & Employment Tax Advisory
T: +27 83 440 5564
E: carolyn.chambers@kpmg.co.za

Cape Town:
Di Hurworth
Partner, Corporate and International Tax
T: +27 82 719 2262
E: di.hurworth@kpmg.co.za

Durban:
Yasmeen Suliman
Partner, Corporate and International Tax
T: +27 82 778 1031
E: yasmeen.suliman@kpmg.co.za

Port Elizabeth:
Tanette Nell
Associate Director, Corporate Tax
T: +27 82 719 2179
E: tanette.nell@kpmg.co.za