Responsible Tax for the Common Good

KPMG's 2016 BudgetWatch

Agenda

01 The economic environment

02 Tax proposals

03 Responsible Tax

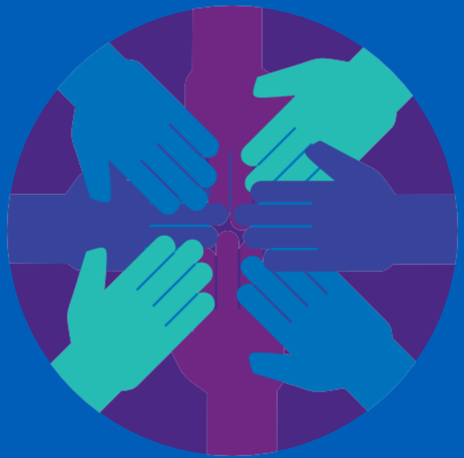
04 Questions?

The economic environment

Jeaunes Viljoen
Economist

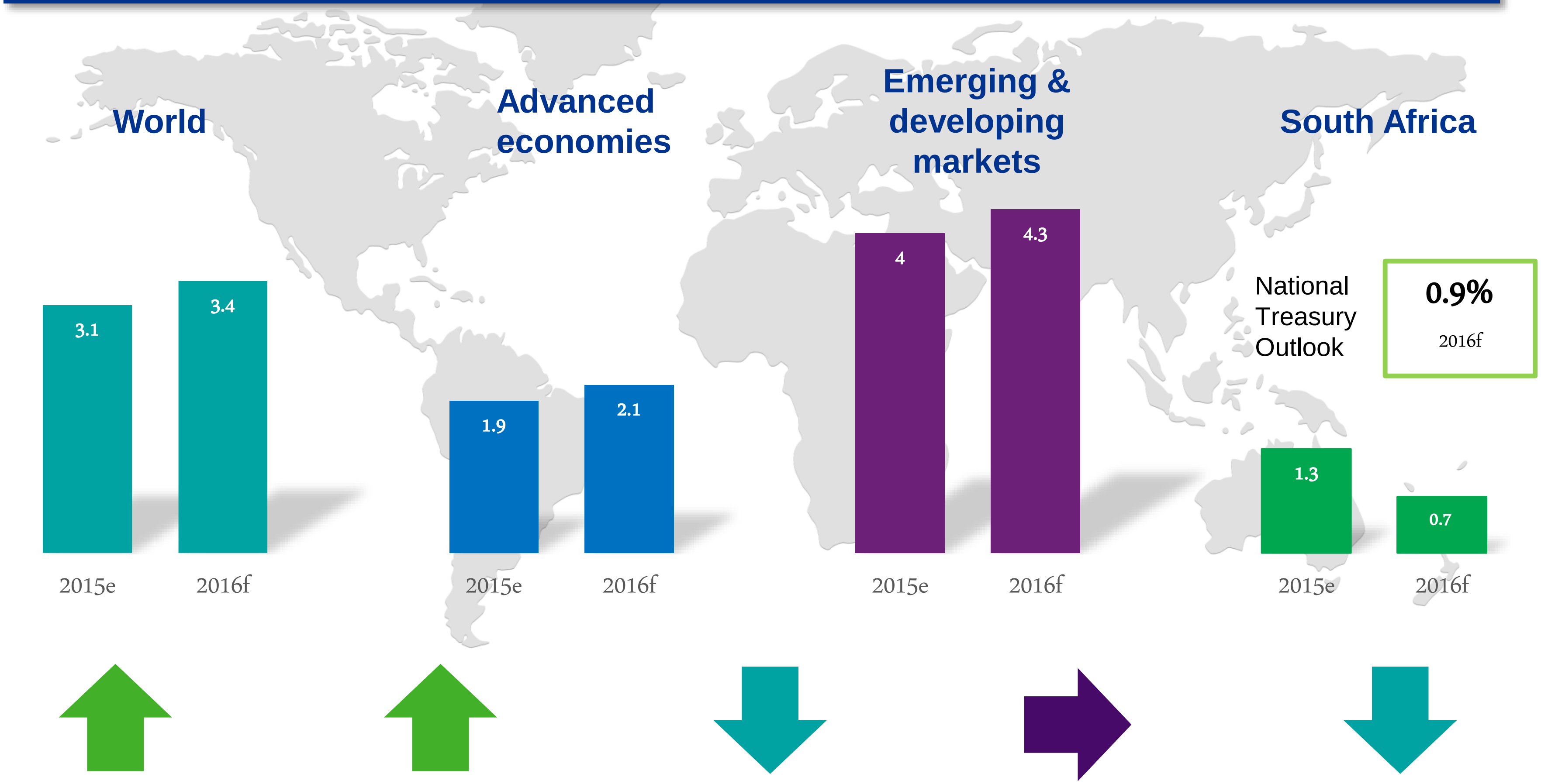
"If we act together, on these principles, as public representatives, civil servants, business people, youth, workers and citizens, we can overcome the challenges of tough economic times and difficult adjustments."

Finance Minister, Pravin Gordhan



The global economic outlook

Despite signs of overall global recovery, SA growth is remains subdued



The U.S.
Growth increase from 2.4% in 2014 to 2.5% in 2015

The Euro Area
Growth of 1.5% in 2015, up from 0.86% in 2014

China
Declined to 6.8% in 2015 from 7.3% in 2014

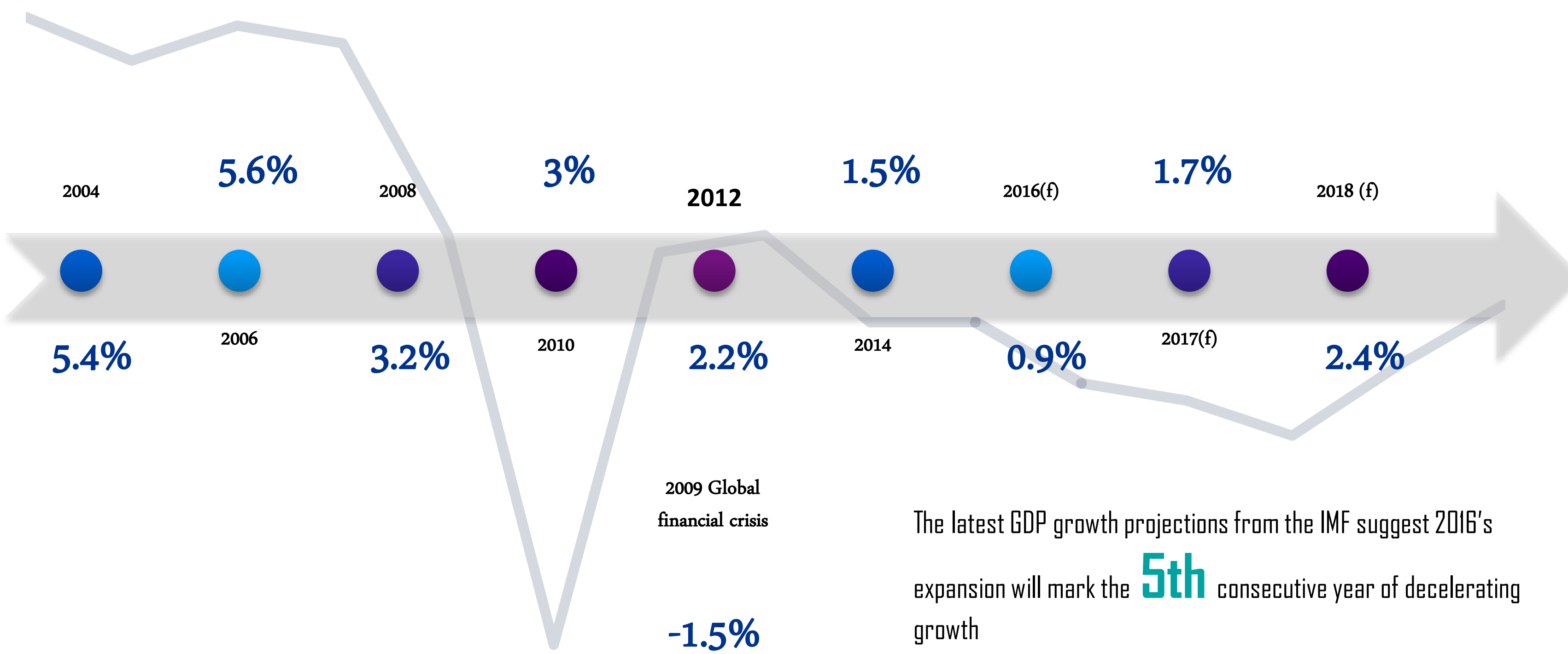
India
Robust growth of 7.3% in 2014 and 2015

Sub – Saharan Africa
Decline to 3.5% in 2015, from 5.0% in 2014

Source: International Monetary Fund (IMF), World Bank

The South African economy

Real GDP growth, % change, 2004-2017f



The latest GDP growth projections from the IMF suggest 2016's expansion will mark the **5th** consecutive year of decelerating growth

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Reasons for slowdown in growth

- ☑ *Weaker Chinese economy*
- ☑ *Weaker exchange rate*
- ☑ *Political instability*
- ☑ *Lower commodity prices*
- ☑ *Electricity supply constraints*

The South African economic outlook

Key economic indicators

		Treasury outlook		Other outlook
	2015	2016 (f)	2017 (f)	2016 (f)
Unemployment (Q2)	25%			25.3%
CPI (November)	4.8%	6.8%	6.3%	6.2%
PPI (November)	4.3%			5.8%
Real prime lending rate* (Q3)	9.44%			10.01%
Current account deficit as percentage of GDP (BER)	-4.0%	-4%	-3.9%	-4.6%
Budget deficit as percentage of GDP	-3.9%	-3.2%	-2.8%	-3.9%
Rand dollar exchange rate Jan 2016	R16.51			R16.86

*Source: SARB ,Statistics South Africa & *Bureau for Economic Research (forecasts)*

However this outlook dependent on next ratings meeting

BBB+ to BBB

Standard & Poor's
Rating: BBB-
Outlook: Negative
= 1 notch from 'junk'

BBB+ to BBB-

Fitch Ratings
Rating: BBB-
Outlook: Stable
= 1 notch from 'junk'

Baa1 to Baa2

Moody's Investors Service
Rating: Baa2
Outlook: Negative
= 2 notches from 'junk'

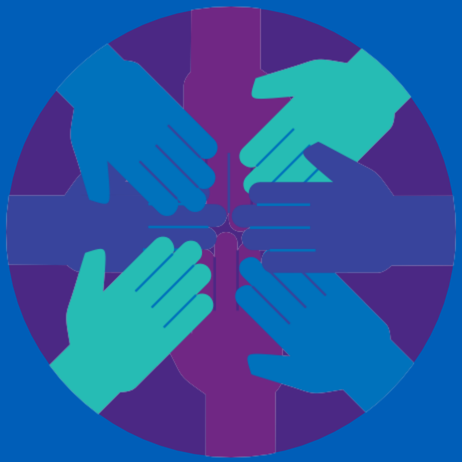
Next credit rating decision:
June 2016, **S&P**

Fitch and **Moody's** have not announced a **proposed date** yet.

The fiscal environment

"This year's Budget is focused on fiscal consolidation. We cannot spend money we do not have. We cannot borrow beyond our ability to repay.
Until we can ignite growth and generate more revenue, we have to be tough on ourselves."

Finance Minister, Pravin Gordhan

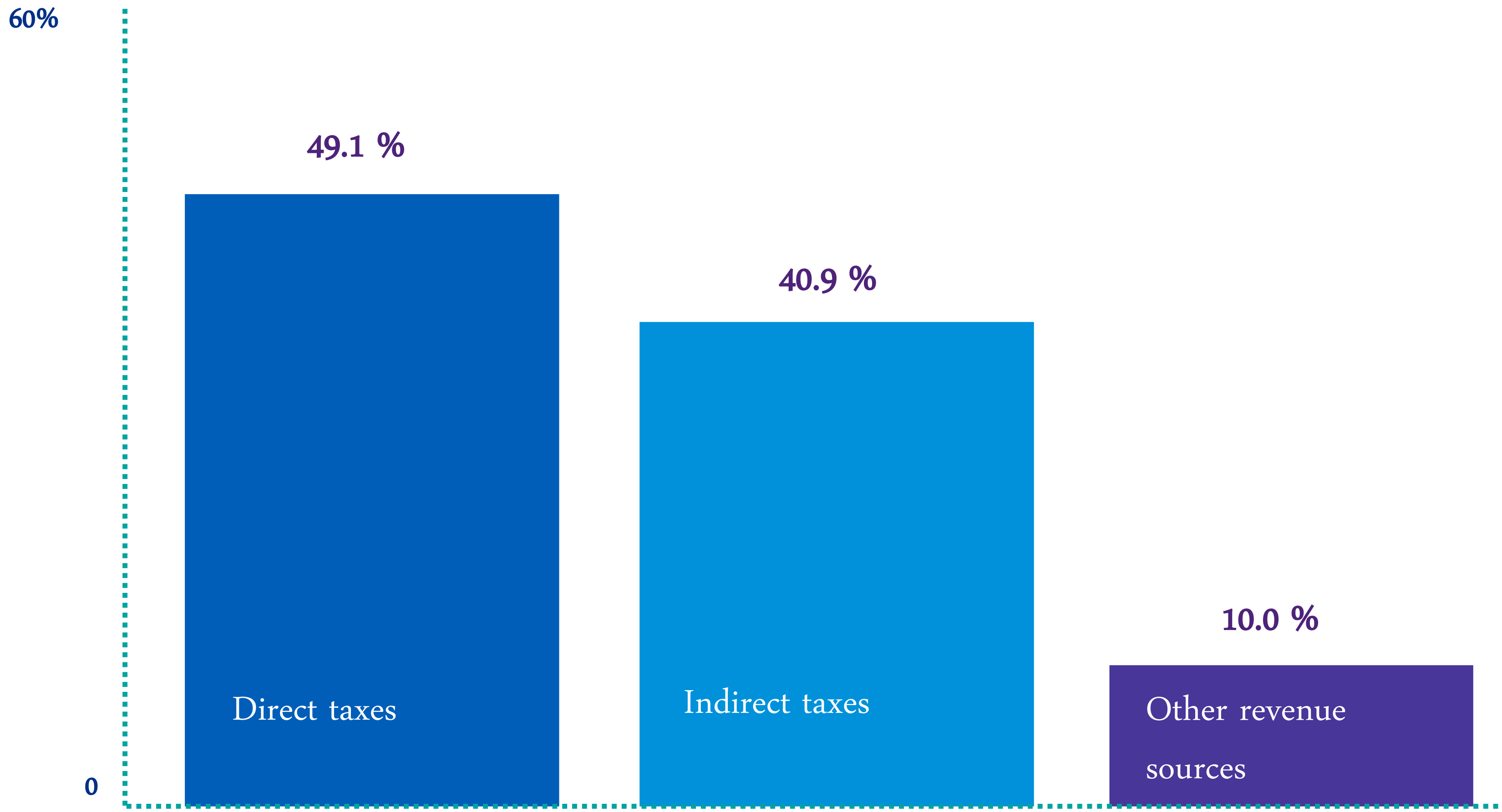


What are the priorities of government policy?

SONA and Budget 2016

Word frequency		
Rank	SONA	Budget
1	Develop	Invest
2	Invest	Growth
3	Sector	Developing
4	Economy	Tax
5	Implement	Social
6	Growth	Service
7	Programme	Fund
8	Financial	Plan
9	Plan	Infrastructure
10	Provide	Increase

Sources of budget revenue



Increased PIT contribution

31% contribution of PIT in 2008/09

37% contribution of PIT in 2015/16

Reduced CIT contribution

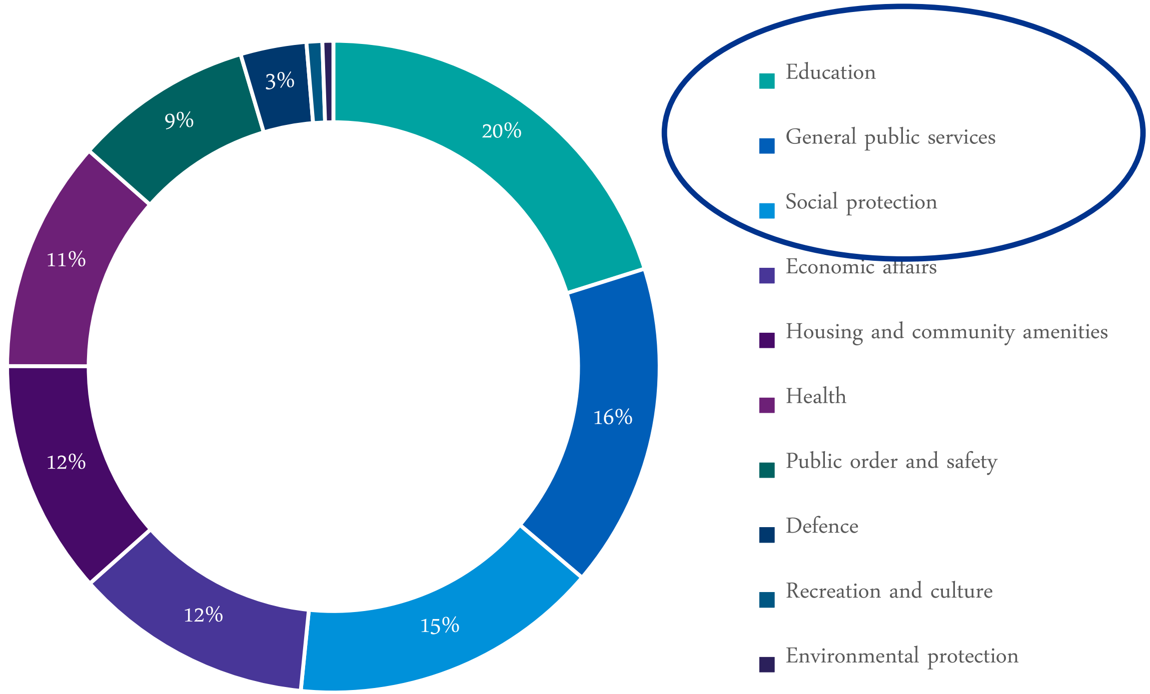
27% contribution of CIT in 2008/09

18% contribution of CIT in 2015/16

Source: National Treasury budget documentation

2016/17 expenditure re-allocation

Expenditure by functional classification



Source: National treasury budget documentation

Expenditure themes

- For every rand in expenditure **36 cents** goes to salaries
- **Debt services cost** are the fastest growing expenditure line over the MTEF
- Expenditure on **education** revised from **R216bn to R245bn** for 2016
- **Social protection** costs rising from **R166bn to R167.5bn** for 2016
- R4.5bn for NHI pilot

Expenditure by economic classification

Wage Bill
35.5%

Transfers and subsidies
32.7%

Debt service costs
11.4%

Payments of capital assets
6.9%

Other expenditure's
13.5%

Medium term expenditure framework

Consolidated fiscal framework, 2015/16 – 2018/19	2015/16	2016/17	2017/18	2018/19
R billion	**Revised**	**Medium-term estimates**		
Revenue	1 223.1	1 324.3	1 436.7	1 571.6
Expenditure	1 380.9	1 463.3	1 572.1	1 695.2
Non-interest expenditure	*1 245.6*	*1 308.9*	*1 403.4*	*1 509.6*
Interest payments	*135.3*	*154.3*	*168.7*	*185.6*
Primary balance	-22.6	15.4	33.4	62
Percentage of GDP	-0.6%	0.4%	0.7%	1.2%
Main budget deficit	-157.9	-139	-135.3	-123.6
Percentage of GDP	-3.9%	-3.2%	-2.8%	-2.4%
Total net loan debt	1 804	2 003	2 194	2 382
Loan debt percentage of GDP	44.3%	45.7%	46.2%	46.2%

Source: National Treasury budget documentation

- South Africa in a primary **budget surplus** over the MTEF
- Budget deficit primarily driven by **debt service cost**
- Net debt increasing by **R578 billion** over the MTEF
- Debt and related servicing of costs likely to increase under current conditions

Debt service costs are **growing at a faster rate** than any other expenditure item

Water resources and bulk infrastructure expenditure
R102 billion

Social grant expenditure
R457.5 billion

Public transport expenditure
R40.7 billion

Transfers to universities
R93.1 billion

Debt service costs
R147.7 billion

Impact of SOE decisions on expenditure

R11.6 billion

2015/16 adjustment in tax revenue

R25.8 billion

2015/16 Increases SOE related expenditure increases

R24.2 billion

Fruitless and wasteful expenditure*

Fruitless and wasteful expenditure = "expenditure which was made in vain and would have been avoided had reasonable care been exercised"

Section 1 of the Public Finance Management Act

"State-owned companies have important roles to play in boosting growth and development. But there are issues to address in their governance, mandates, financing and operations."

Minister Pravin Gordhan

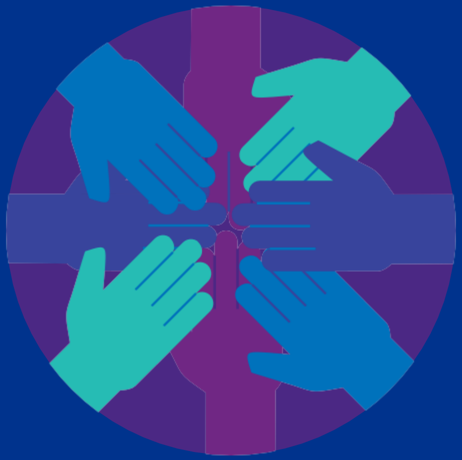
Source: National Treasury budget documentation

Government needs to tighten on wasteful expenditure and put stricter conditions on SOE management to avoid adjustments to expenditure ceiling.

Impact of tax policy

“Tax compliance lies at the heart of nation building and social cohesion. Without a buoyant revenue base, a nation cannot develop and succeed”

Former Finance Minister, Nhlanhla Nene



Impact of tax proposals

Proposal	Revenue impact	Policy impact
Capital gains tax	R0.95 billion	Increase in capital gains tax to discourage the **disposal of assets**.
PIT bracket adjustment	R7.6 billion	Personal income tax relief to **reduce the impact of inflation** on middle- and low-income earners.
Specific excise taxes	R2.3 billion	Punitive increases in excise taxes may **encourage grey market activity**, particularly in alcohol beverages and tobacco industries.
Fuel taxes	R6.8 billion	The weak rand means despite low oil prices, the **higher fuel levy** will have an **above-inflationary effect**. This will have economy-wide implications.

Introduction of new taxes

The implementation of a tax on sugar-sweetened beverages has **implications not only for consumers**, but would also has **far-reaching consequences for the South African beverages industry.**

The beverage subsector currently contributes **2.7% to manufacturing**, highlighting the potential negative impact on the South African economy.

35% of households owning or having access to cars, motorcycles, trucks or kombis – all of whom will now be **subject to the tyre tax in conjunction with the fuel levy** increase of 30c, putting additional strain on households' spending power.

So what does this mean?

"If we do not achieve growth, revenue will not increase. If revenue does not increase, expenditure cannot be expanded."

Finance Minister Pravin Gordhan quoting former Finance Minister, Nhlanhla Nene

What the budget aims to achieve for …

… the fiscus?

- **Consolidation** of fiscal balance over time
- Modest and CPI-linked increases of social protection expenditure
- To **reduce the risk of a downgrading**, budget emphasised private participation and consolidation of SOCs.
- Constraint on **public sector wage** increases
- Constrained fiscal space necessitates **future tax increases**

… the broader economy?

- Build a **productive and healthy workforce** to boost sustainable growth through the prioritisation of **education** and **health.**
- Efficiency and cost cutting due to **reduction in fiscal spending capacity.**
- **Job creation** through emphasis on SME support.
- **Greater cooperation** between **government and private sector** an opportunity for PPPs
- Enable economic growth through **enhanced infrastructure investment**, public transport, broadband, and other infrastructure incentives

Turning challenges into opportunities

"I am fundamentally an optimist. Whether that comes from nature or nurture I cannot say. Part of being optimistic is keeping one's head pointed toward the sun, one's feet moving forward. There were many dark moments when my faith in humanity was sorely tested, but I would not and could not give myself up to despair. That way lay defeat and death."

Finance Minister Pravin Gordhan quoting former President, Nelson Mandela

Ratings agencies' reaction to overall budget speech

Economic growth to rise over medium term

2.4%

by 2018

Stabilise debt as a percentage of GDP

46.2%

by 2017/18

Fiscal measures over medium term to narrow budget deficit

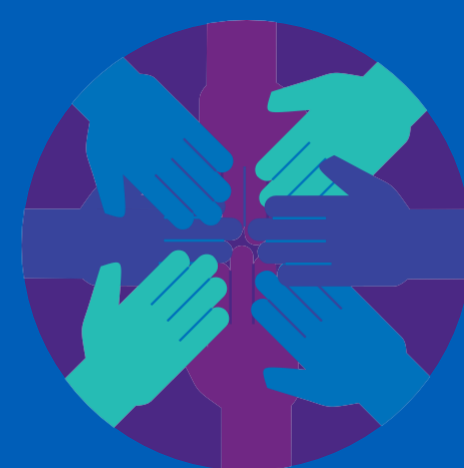
2.4%

by 2018/19


ACTIONS
SPEAK LOUDER THAN WORDS.
EM-MEDIA, INC.

So let's talk tax

Joubert Botha
Director: Tax Services
Vian Strydom:
Associate Director: Tax
Services



A simple message

"I have a simple message. We are strong enough, resilient enough and creative enough to manage and overcome our economic challenges."

The current tax landscape

“If we act together, on these principles, as public representatives, civil servants, business people, youth, workers and citizens, we can overcome the challenges of tough economic times and difficult adjustments.”

Finance Minister, Pravin Gordhan

What does the current tax landscape look like?

Low economic growth + Increased revenue targets + Revenue collection under pressure

SARS headcount remains unchanged + Technology and the information age + Drive towards transparency and tax morality

=

More aggressive SARS/Increased disputes + Complex legislation + TAA is a one way street

+ SARS is requesting information + Information exchange + Tax management and governance

Tax changes

"If we act together, on these principles, as public representatives, civil servants, business people, youth, workers and citizens, we can overcome the challenges of tough economic times and difficult adjustments."

Finance Minister, Pravin Gordhan

"This year's Budget, Honourable Speaker, is focused on fiscal consolidation. We cannot spend money we do not have. We cannot borrow beyond our ability to

Agenda

01 Individuals

02 Value Added Tax

03 Corporate Tax

04 Other

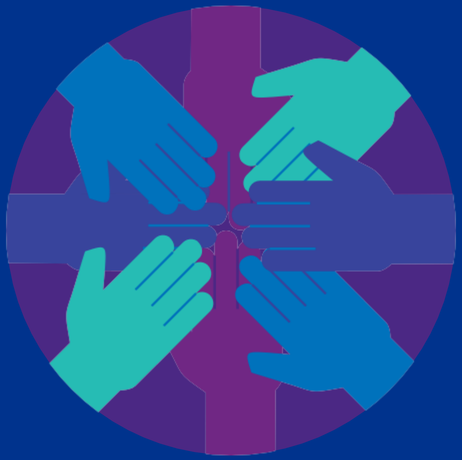
05 Anti-Avoidance

Individuals

"Tax transparency has become highly topical."

Chris Morgan [Tax Partner: KPMG UK]

Fewer than 1 million individuals contribute 64 per cent of personal income tax revenue



"This year, in view of the need to raise additional revenue and reduce the budget deficit, we have paid special attention to the fairness and inclusivity of the tax system. We have also been mindful of the need to moderate the impact of tax increases on

Individuals

2015/2016		2016/2017	
R0 - R181 900	18% of each R1	R0 - R188 000	18% of each R1
R181 901 - R284 100	R32 742 + 26% of the amount above R181 900	R188 001 - R293 600	R33 840 + 26% of the amount above R188 000
R284 101 - R393 200	R59 314 + 31% of the amount above R284 100	R293 601 - R406 400	R61 296 + 31% of the amount above R293 600
R393 201 - R550 100	R93 135 + 36% of the amount above R393 200	R406 401 - R550 100	R96 264 + 36% of the amount above R406 400
R550 101 - R701 300	R149 619 + 39% of the amount above R550 100	R550 101 - R701 300	R147 996 + 39% of the amount above R550 100
R701 301 and above	R208 587 + 41% of the amount above R701 300	R701 301 and above	R206 964 + 41% of the amount above R701 300

Individuals

Tax bracket changes

- Rates remain consistent
- Savings for earnings below R550 100
- Primary rebate increases with R243 (1,8%)

Medical tax credits

- Increased from R270 to R286 (6%) for first two beneficiaries
- Increased from R181 to R192 (6%) for additional beneficiaries

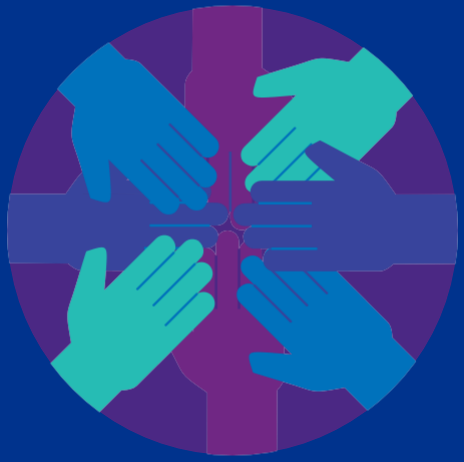
Retirement savings

- Tax deductions for provident fund contributions to match taxable fringe benefits.
- Annuitisation delayed to 1 March 2018

Value Added Tax

"Tax transparency has become highly topical."

Chris Morgan [Tax Partner: KPMG UK]



Value added tax: Strong indication of increases in 2017 and 2018

"Last year, government increased marginal rates of personal income tax. In future, the balance between taxes on income (direct taxes) and consumption (indirect taxes) will be an important consideration in ensuring a diversified, efficient, equitable and sustainable tax system. The current tax mix suggests that there may be greater room to increase indirect taxes, such as VAT."

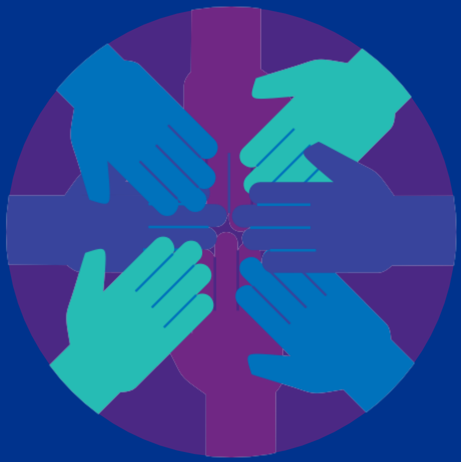
Value added tax: Corrections

Description	Change
Taxation of non-executive directors' fees	A non-executive director's fees may be subject to both employees' tax (PAYE) and VAT. Views differ on whether to deduct PAYE from these fees or if the director should register as a VAT vendor. It is proposed that these issues be investigated to provide clarity.
Grants from the National Skills Fund	The Value-Added Tax Act (1991) zero-rates grants allocated through sector education and training authorities (SETAs), but does not specifically mention those allocated through the National Skills Fund. Aligning the VAT treatment of these two grant allocations will be considered.
Loyalty programmes	It is proposed that loyalty programmes be analysed and legislative amendments be considered to provide clarity on their VAT treatment. The provisions relating to vouchers will also be reviewed to determine if they require amendments.
Determined value of company cars	It is proposed that the provisions of the VAT Regulation 2835 be aligned with the provisions of the Seventh Schedule of the Income Tax Act to avoid an undue administrative burden.
Alignment of prescription periods	It is proposed that an input tax deduction be limited in certain instances to the tax period in which the time of supply occurred. In addition, it is proposed that the time limit for the payment of refunds be clarified.

Corporate Tax

"Tax transparency has become highly topical."

Chris Morgan [Tax Partner: KPMG UK]



Corporate tax: Savings to address key initiatives

Description	Change
Increasing the incentive for employers to provide bursaries	The value of qualifying bursaries will be increased from R10 000 to R15 000 for National Qualifications Framework levels 1 to 4, and from R30 000 to R40 000 for levels 5 to 10.
Research and development	A task team established by the Minister of Science and Technology is investigating the challenges faced by businesses in trying to access the R&D tax incentive. Its work should be completed in April 2016, after which proposals will be considered to enhance this incentive.
Education and training-based public benefit activities	Government is considering expanding the list of public-benefit education and training activities to accommodate industry-based training organisations, which would exempt them from tax.
Infrastructure investment in mining communities	The Mining Charter requires companies to invest in communities where they operate. It is typically agreed that a company will build housing, hospitals, schools and recreational facilities to benefit workers and communities. Companies can only deduct such capital expenditure if it relates directly to employees. Government proposes that the same relief be provided for community-related expenditure.

Corporate tax: Savings to address key initiatives

Description	Change
Venture capital funding for small businesses	Government is aware that the application of certain provisions on equity funders to venture capital companies may result in potential investors abandoning plans to take up this incentive. Measures to mitigate unintended consequence will be explored
Urban development zones	It is proposed that the UDZ tax incentive be made available to more municipalities

Corporate tax: Corrections

Description	Change
Clarifying the tax treatment of government grants	It is proposed that all government grants be included in gross income and the Eleventh Schedule be the sole mechanism for determining whether they are taxable or not.
Withdrawal of withholding tax on service fees	It is proposed that the withholding tax on service fees be withdrawn from the Income Tax Act and dealt with under the provisions of reportable arrangements in the Tax Administration Act (2011).
Bad debt deduction	It is proposed that section 11(i) of the act be amended to specifically apply to any exchange difference in respect of a debt that has been included in income

Corporate tax: Corrections

Description	Change
Interest withholding tax where interest is written off	In situations where interest withholding tax is paid on interest that becomes due and payable, but the interest is subsequently written off as irrecoverable, there is no mechanism for a refund of interest withholding tax already paid. It is proposed that a mechanism be developed to allow for a refund of interest withholding tax paid.
Extension of objection and condonation periods	The current period for lodging an objection under the Tax Administration Act is 30 business days from the date of assessment. This has been shown to be too short in practice, particularly in complex matters, resulting in a large number of applications for condonation. It is therefore proposed that a longer period for lodging an objection and condonation be considered. Amendments to the dispute resolution rules will also be required to give effect to this proposal, which could result in a change to the rules for failing to comply within the prescribed time periods.

Other

“Tax transparency has become highly topical.”

Chris Morgan [Tax Partner: KPMG UK]

Other

Description	Change
CGT	Increase the inclusion rate for capital gains for individuals from 33.3 per cent to 40 per cent, and for companies from 66.6 per cent to 80 per cent.
Transfer duty	Government proposes to increase the transfer duty rate on property sales above R10 million from 11 percent to 13 per cent.
Voluntary disclosure	Government proposes to relax voluntary disclosure rules for a period of six months, from 1 October 2016, to allow non-compliant individuals and firms to disclose assets held and income earned offshore
Tax treatment of trusts	Government proposes to ensure that the assets transferred through a loan to a trust are included in the estate of the founder at death, and to categorise interest-free loans to trusts as donations.

Other: Cleaner environmental expenditure

Description	Change
Encouraging the manufacture of clean fuels	Accelerated tax allowances
Renewable energy incentives	Accelerated tax allowances on infrastructure
Fuel taxes	Increase of 30c/litre (Petrol increased to R2.85/ litre and Diesel to R2.70/litre)
Tyre Levy	Implemented at a rate of R2.30/kg of tyre, effective 1 October 2016
Incandescent globe tax	Levy be increased from R4 to R6 per globe, effective 1 April 2016
Plastic bag levy	Increase the levy from 6 cents to 8 cents per bag, effective 1 April 2016
Motor vehicle emissions tax	Increase the tax rate from R90 to R100 for every gram of emissions/km
Implementation of carbon tax	The draft Carbon Tax Bill was published in November 2015, with 90 comments received to date. The draft bill will be revised, taking into account public comments and further consultation

Other: Promoting public health and social wellbeing

Description	Change
Taxing sugar-sweetened beverages	Government proposes to introduce such a tax on 1 April 2017 to help reduce excessive sugar intake
Excise duties on alcoholic beverages and tobacco products	Excise duty rate increases of between 6.7 per cent and 8.5 per cent

Anti-avoidance

“Tax transparency has become highly topical.”

Chris Morgan [Tax Partner: KPMG UK]

Additional measures to protect the tax base

Description	Change
Hybrid debt instruments	Financially distressed companies may require debt instruments to be subordinated. Subordination will result in the debt being regarded as a hybrid debt instrument. It is proposed that a concession be made to exclude debt instruments subject to a subordination agreement from being regarded as section 8F hybrid debt instruments
Hybrid debt instruments	Implement measures, effective 24 February 2016, to eliminate mismatches associated with hybrid debt instruments where the issuer is not a South African resident taxpayer. Such situations potentially result in double non-taxation.
Avoidance schemes in respect of share disposals	One of the schemes used to avoid the tax consequences of share disposals involves the company buying back the shares from the seller and issuing new shares to the buyer. The wide-spread use of these arrangements merits a review to determine if additional countermeasures are required.

Base erosion and profit shifting

In recent years, greater attention has been paid to multinational companies that avoid or evade tax by shifting taxable income to low-tax regimes or tax havens. Such practices reduce the corporate income tax base and put domestic companies at a disadvantage.

Of particular concern:

- Unacceptable transfer-pricing practices: where the value or nature of cross-border transactions is manipulated to obtain a tax benefit.
- Treaty shopping: where related companies in different countries establish a third entity in another location to obtain tax-treaty benefits.
- Highly geared financing structures: that reduce companies' tax liabilities with excessive interest-expense deductions.

Base erosion and profit shifting

South Africa has been proactive and in many instances at the forefront in taking policy action in this area and Government has taken the following steps:

- South Africa is working with 93 other governments to develop a multilateral instrument that will enable preventive measures to be incorporated into the existing network of bilateral treaties.
- Improving the quality of information firms must provide to SARS, enabling it to identify aggressive or abusive tax-planning schemes.
- Large multinationals will be required to submit reports for each country in which they do business to the tax authority where their head office is located. Tax authorities will share this information starting in 2018. SARS will have access to country-by-country information on all large multinationals operating in South Africa.
- Enhancing rules on foreign companies controlled by a South African resident, so that a portion of profits earned by a South African-owned subsidiary operating in another country is taxed in South Africa if no meaningful economic activity took place in the other country.
- Introducing rules that limit excessive interest deductions
  - Section 8F and 8FA
  - Transfer pricing
  - Section 23N
  - Section 23M

Anti avoidance

Limitation

How does tax in SA compare?

"Tax transparency has become highly topical."

Chris Morgan [Tax Partner: KPMG UK]

How does tax in SA compare?

South Africa's tax burden sits roughly between the average for developing and developed economies

	Personal income tax	Corporate income tax	Value-added tax
Germany	4 7.5	3 0.2	1 9.0
Russia	1 3.0	2 0.0	1 8.0
Brazil	2 7.5	3 4.0	17-19.0
UK	4 5.0	2 0.0	2 0.0
Canada	4 9.5	2 6.3	5 .0
Australia	4 6.5	3 0.0	1 0.0
South Africa	**4 1.0**	**2 8.0**	**1 4.0**
China	4 5.0	2 5.0	1 7.0
Kenya	3 0.0	3 0.0	1 6.0
Ghana	2 5.0	2 5.0	1 5.0

The key question is whether the taxpayer receives value for money

What is responsible tax?

"Tax transparency has become highly topical."

Chris Morgan [Tax Partner: KPMG UK]

"In recent weeks, President Zuma, other Ministers and I have engaged with business leaders to understand their concerns and views. Confidence and shared understanding

So what is responsible tax?

"The payment of taxes is enforced by law, but effective tax systems rely on the voluntary adherence of citizens and a culture of tax morality."

Obligations

- Taxpayers obligations: To pay the right amount of tax (within the four corners)
- Governments and Revenue Authorities obligations: To align tax revenues to the social requirements/needs
- The expectation is that the taxpayer receives value for money

Minister of Finance Pravin Gordhan stated the following:

"I am deeply mindful that we have a corresponding obligation, as government, to improve the impact of every rand spent, and to eliminate waste and corruption."

Tax morality

- Is there a morally right amount of tax?
- Paying the right amount of tax vs the morally correct amount
- Give back to community: common good

Minister of Finance Pravin Gordhan stated the following:

"The Budget rests on the idea of an inclusive social contract, encompassing an equitable burden of tax and a progressive programme of expenditures. The Budget relies on institutions of good governance and a public ethic that values honesty and fairness."

So what is responsible tax?

'Information sharing will enable tax authorities

to act more effectivel against illicit flows ar abusive practices"

Tax transparency

- Transparency is essential in restoring trust
- Organisations to proactively engage with all stakeholders in the debate

The OECD Base Erosion and Profit Shifting Project states in Action13:

"the September 2014 Report on Action 13 (the "September 2014 Report") provides a template for Multinational Enterprises (MNEs) to report annually and for each tax jurisdiction in which they do business the information set out therein. This report is called the Country-by-Country (CbC) Report."

As part of the measures to improve large business tax compliance, the HMRC stated the following:

"To respond to the challenges described in Chapter 1, the Government proposes to introduce a legislative requirement that large businesses must publish their tax strategy as it relates to or affects UK taxation. The strategy should be formalised, articulated and owned by an Executive Board member within the business."

Minister of Finance Pravin Gordhan stated the following:

"With effect from 2017, international agreements on information sharing will enable tax authorities to act more effectively against illicit flows and abusive practices by multinational corporations and wealthy individuals."

So what is responsible tax?

"The issues around ta
compliance, and
planning need to be
the corporate
governance agendas
company boards"

The consequence

- The tax profile has been raised
- Change in attitude
- Challenging environment
- Organisations are mandated to apply good governance principles to ensure compliance

Minister of Finance Pravin Gordhan stated the following around governance:

"The issues around tax, tax compliance, and tax planning need to be on the corporate governance agendas of company boards. SARS hoped to do a lot more to interact with companies and boards to expose them to what was happening elsewhere in the world on the one hand, but also to indicate the urgency for them to bring tax onto the corporate governance agenda."

The answer

- Taxpayer to implement proper tax management and governance structures within the organisation
- Governments and Revenue Authorities to follow an open, honest and transparent risk based approach in evaluating taxpayers

Questions ?