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TAX

2020/2021 Budget Proposals – Tax Overview

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INTRODUCTION

From 2015/2016, year on year there have been upward adjustments to the various tax rates, including the increase in the personal income tax rate from 41% to 45%, an increase in the effective CGT rate across the board, the increase in dividends tax from 15% to 20%, and more recently the increase in the VAT rate from 14% to 15%, as well as the increase in the estate duty and donations tax rates from 20% to 25%.

It is no surprise that further rate increases were anticipated in the 2020 Budget, with many suggesting that there would be an increase in the maximum marginal rate for individuals coupled with an increase in the CGT inclusion rate and possibly even an increase in the VAT rate, all of which would add to the ever-increasing burden of South African taxpayers. However, the Minister of Finance managed to deliver comparably less shocks than prior years with no specific tax rate increases, which were primarily motivated by a weak economy and muted growth outlook.

Unlike with the 2019 Budget that saw no adjustment to the tax brackets for all taxpayers, the 2020 Budget provides for an above inflation adjustment across all brackets.

Somewhat optimistically, the 2019 Budget projected real economic growth of 1.5% in 2019 and 1.7% in 2020 which has now been adjusted downwards to 0.3% for 2019 and 0.9% in 2020. The impact of this low growth has resulted in an expectation that a staggering R63.3 billion less revenue is expected to be collected for 2019, an amount which is greater than the shortfall that arose from the 2008 financial crisis.

The 2020 Budget seeks to reduce the main budget expenditure baseline by R156.1 billion over the next three years in comparison with 2019 Budget projections. The net reduction is mainly the result of a R160.2 billion reduction to the wage bill of national and provincial departments, and national public entities and through reallocations and additions totalling R111.1 billion, of which R60.1 billion is set aside for Eskom and SAA.

The 2020 Budget, nevertheless, estimates that tax revenue of R1.43 trillion will be raised, which is an increase of 4.9%. The major contributor to the increase in tax revenue is anticipated to come from a more efficient SARS, which is a dose of déjà vu.

The efficiency is anticipated to be bolstered through assistance from the re-established Davis Tax Committee to address tax leakages, customs fraud, trade mispricing and harmful tax practices. It is also envisaged that a new centre focused on wealthy individuals who have complex tax arrangements is to be formed. The new centre will have a renewed focus on illicit and criminal activity, including non-compliance of religious public-benefit organisations. In this context, it is well known that income derived from illegal receipts remains taxable – it just happens that income derived illegally often escapes the tax net not because it is not taxable, but because the revenue authorities are not aware of its existence. SARS need not look too far in this regard.

Short of the taxes mentioned hereon, no significant or unusual tax rate increases were announced, and this recognises the fact that the income tax rates are all close to the maximum that taxpayers can bear. Any further increases would certainly result in higher non-compliance, making South Africa unattractive for foreign investment. However, what is encouraging is the Minister's announcement to reduce the corporate tax rate in the future from its current 28%, to be financed by a reduction in tax incentives.

In addition to the tax changes, the Budget documentation sets out a significant number of proposed amendments to the various fiscal Acts. Many of these are either of a highly technical or esoteric nature, and therefore this overview reports only on those believed to be of more widespread interest to individuals and companies.

INDIVIDUALS

EXPATRIATES

It was announced in the 2019 Budget Speech that, with effect from 1 March 2020, foreign remuneration in excess of R1 million earned by South African tax residents working abroad would be subject to tax in South Africa. Up and until 1 March 2020, foreign remuneration of tax resident natural persons was fully exempt if the necessary requirements in the Income Tax Act (the Act) were met. The threshold has now been increased to R1.25 million.

VENTURE CAPITAL COMPANIES

Venture Capital Company (VCC) legislation (section 12J of the Act) was enacted to encourage investment into small and medium enterprises by providing a tax deduction to an investor who subscribes for shares in the VCC. Since its introduction in 2009, section 12J has been subject to a 12-year sunset clause i.e. the benefits it affords is only available in respect of shares issued before 30 June 2021. This sunset clause currently remains in place until Government reviews the effectiveness, impact and role of the section 12J regime to determine if the sunset clause should be extended.

FUNDING OF TRUSTS

Since 2016, rules were introduced to levy donations tax on low-interest and interest-free loans by individuals to local and foreign trusts. In 2017, these rules were amended to apply to loans made to companies owned by the trusts.

These rules will now be amended so that they apply to preference share funding that is provided to such local or foreign companies that are wholly or partly owned by local or foreign trusts, where the dividends paid in respect of those preference shares fall below a prescribed level.

CORPORATES

CURTAILING EXCESSIVE INTEREST DEDUCTIONS

Historically, for income tax purposes, the deduction of interest expenses from a taxpayer's income (from carrying on a business) has been limited by thin capitalisation and transfer pricing rules, and specific anti-avoidance measures (relating to corporate re-organisations that involve loans and loans from a controlling shareholder who is wholly or partly exempt from any tax on the interest).

In order to curb base erosion and profit shifting arising from excessive interest deductions, and in common with many other countries, a new rule will be introduced. It is proposed that the rule will prevent taxpayers from deducting interest expenses (on debts owed to connected persons and third parties) in excess of 30% of their "adjusted taxable income" or so-called "tax EBITDA".

Any interest expense that is not allowed to be deducted under this rule, in a particular tax year, may be carried forward by the taxpayer for deduction in a future tax year, subject to the same limitation in that tax year.

LIMITATIONS ON ASSESSED LOSSES

In what is a significant development, with effect for years of assessment ending on or after 31 December 2021, companies will only be allowed to claim assessed losses brought forward against 80% of their income for the current year.

CORPORATE ROLL-OVER PROVISIONS

Section 45 of the Act provides for the tax neutral transfer of assets between companies that form part of the same group of companies by way of intra-group transactions. Often this involves a sale of an asset on loan account.

The intra-group rules contain a so-called "de-grouping" charge, which unwinds the tax neutral treatment of an intra-group transaction in the hands of the transferee. This de-grouping charge is imposed if the de-grouping occurs (i.e. either the transferor or the transferee exits the group) within 6 years of the intra-group transaction. In the case of such a de-grouping, the transferee triggers a deemed capital gain and/or recoupment of depreciation.

The penal effect of a de-grouping does not stop here because in addition to this, the consideration paid to the company disposing of the asset, the loan account in the above example, has a nil base cost.

If the loan is repaid after a de-grouping, a gain also arises for the creditor company being repaid. Accordingly, in a de-grouping scenario, economically speaking, both companies are subject to tax on the same asset. This will be addressed in the 2020 legislative cycle.

MINING TAX

In its current form, the Act provides taxpayers, who earn income from mining operations, an accelerated capital expenditure deduction. There is debate as to what qualifies as "mining" and "mining operations", specifically in the context of contract mining, for purposes of claiming the capital expenditure deduction. It is anticipated that Treasury will assess the provisions dealing with allowable capital mining expenditure.

Currently, tax-deductible capital expenditure incurred on a mine may not be used to reduce the taxable income of another mine owned by the same taxpayer unless the Minister of Finance, in consultation with the Minister of Mineral Resources and Energy, agrees. Due to the issues which this discretion has caused, it is anticipated that Treasury will assess this discretion and, if not remove it completely, at least restructure it.

EMPLOYMENT TAX INCENTIVE (ETI)

The ETI is aimed at encouraging employers to hire young work seekers. It reduces an employer's cost of hiring work seekers between the age of 18 and 29 by allowing the employer to reduce its monthly employees' tax (PAYE) liability by an amount of up to R1 000 per qualifying employee.

If an employer did not claim the ETI in respect of a particular month despite it being available in respect of that month, then the employer would still be entitled to claim it in a subsequent month. Any unclaimed ETI will be forfeited by the employer if it is not claimed by the end of August or February, whichever is the last month of the relevant employees' tax reconciliation period.

An employer may only claim the ETI in respect of a particular month if it has no outstanding tax returns or tax debts on the last day of such month. However, if the employer is non-compliant, it would be entitled to roll-over the available but unclaimed ETI in respect of the particular month to a subsequent month in which it becomes tax compliant, even if this month falls after the August or February employees' tax reconciliation deadlines.

It is proposed that the ETI legislation be amended in order to address this anomaly as it currently benefits non-compliant employers more than compliant employers.

INTERNATIONAL

LOOP STRUCTURES – PREVENTING TAX BASE EROSION THROUGH TAX LAWS

Until 31 October 2019, South African resident individuals were not allowed to hold shares in an offshore company that in turn held investments in South Africa. This constitutes a so-called loop structure for exchange control purposes and the prohibition against such a structure has been aimed at preventing the export of capital and protecting the tax base. From 31 October 2019, South African exchange control resident individuals can now hold up to 40% in a foreign company that in turn holds investments in South Africa.

It was not specifically announced that the restriction on "loop" structures will be removed entirely, but it is now suggested that the proposed amendments to the taxation of dividends and gains from the controlled foreign companies (CFC) will address the apparent mischief. A CFC is an offshore company in which South African residents, either alone or collectively, hold more than 50% of the participation rights. In short the CFC rules provide for its profits to be taxed in its shareholders' hands.

The CFC rules are currently such that if a South African individual holds at least 10% of the equity shares and voting rights in a CFC, and that CFC received dividends from a South African company, which it on-declared to the South African shareholder, that shareholder would receive the dividends tax free. Similarly, under the current rules, a South African tax resident shareholder of a CFC could dispose of his or her shares in a CFC that has unrealised capital gains in respect of South African investments, without triggering any tax. The CFC rules will be amended so that any dividends that flow from a South African company to a South African shareholder of a CFC will be subject to tax at 20% and the participation exemption for capital gains on the disposal of shares in CFCs by residents will not apply to the extent that the value of those shares is derived from South African assets.

COMPANIES CEASING TO BE TAX RESIDENT

When a company ceases to be a South African tax resident, there is a deemed disposal of its assets and, if this deemed disposal results in a capital gain, a CGT event is triggered in the hands of the company. In addition, in effect all of its realised and unrealised reserves are deemed to be distributed as a dividend, triggering dividends tax. Despite this, when a South African resident holds equity shares in a foreign company and disposes of those shares to a person who is not resident, the South African resident (subject to certain requirements) can disregard any capital gain in respect of that disposal. This is often referred to as the participation exemption.

In comparison, when a South African resident holds shares in a South African company and disposes of those shares, that disposal is subject to CGT in the shareholder's hands.

It is suggested that the participation exemption creates an unanticipated loophole whereby a company can cease to be a South African tax resident in anticipation of a sale of shares between its South African tax resident shareholder and a non-resident, the consequence of which there will be no CGT consequences for the South African tax resident shareholder. It is proposed that the legislation will be amended to close this supposed loophole.

FOREIGN DIVIDEND EXEMPTION

In its current form, the Act exempts a South African resident (holding at least 10% of the total equity shares and voting rights in a foreign company) from paying normal tax on any foreign dividends it receives or accrues from that foreign company.

To avoid abuse of this section, the exemption is denied if the foreign dividend is determined directly or indirectly from any amount paid or payable by any person to any other person. For example, if a South African resident holds shares in both a foreign company and a South African company and the foreign company receives service fees from the South African company and thereafter declares a foreign dividend to its South African shareholder, the foreign dividend will not be exempt but will be subject to 20% dividends tax in the hands of the South African resident shareholder. While the exemption does not apply to amounts which arose (directly or indirectly) from deductible payments, it is proposed that amendments will be made to the legislation to enhance this principle.

VAT

CLARIFICATION OF THE VAT TREATMENT OF TRANSACTIONS TAKING PLACE IN TERMS OF SECTIONS 42 AND 45 OF THE ACT

In the case of a supply made in terms of an intra-group transaction as defined in section 45 of the Act, section 8(25) of the VAT Act deems the supplier and recipient to be one and the same person, but only if the enterprise is supplied on a going concern basis. If they are not, VAT at 15% must be levied. However, certain assets forming part of a "going concern" may not receive the relief afforded by section 45, in which case VAT is to apply. This is not aligned with a general VAT relief provision for a supply of a going concern.

EXCHANGE CONTROL

Treasury proposes modernising the foreign-exchange system. Since 1933, South Africa has operated a "negative list" system. By default, foreign-currency transactions are prohibited, except for those listed in the Currency and Exchanges Manual. It is acknowledged that this regime constrains trade and cross-border flows, particularly in relation to fast-growing African economies.

Over the next 12 months, a new capital flow management system will be put in place. All foreign-currency transactions will be allowed, except for a risk-based list of capital flow measures. This list includes that the export of intellectual property for fair value to non-related parties will not be subject to approval. The corollary of this is that related party intellectual property sales will still require approval. Further, the current policy of certain loop structures, which relates to the acquisition by private individuals of equity and/or voting rights in a foreign company, will remain until tax amendments are implemented to address the risks. South African corporates will not be allowed to shift their primary domicile, except under exceptional circumstances approved by the Minister of Finance. The position pertaining to dual-listed structures and existing approvals pertaining to such structures will be modified to align with the FDI requirements and policy.

This will represent the single largest relaxation of controls since they were imposed in 1961, because, provided the list of restrictions is not lengthy, residents will largely be free to remit funds abroad.

The announcement also indicated the intention to abolish the notion of "formal" or "financial" emigration for exchange control purposes, and will be phased out by 1 March 2021. This will be replaced by a "verification process" based on legitimacy of source of funds, tax compliance status, anti-money laundering and counter terror financing requirements. The current emigration process already requires an extremely in-depth "verification" by SARS of funds of the individual emigrating, so it will be interesting to see what this new process entails.

Under the proposed new system, emigrants and residents will be treated identically, with restrictions on emigrants' local blocked accounts and borrowings in South Africa to be repealed. Individuals who transfer more than R10 million offshore will also be subject to a new stringent "verification process".

Finally, individuals are only allowed to withdraw funds from their pension preservation fund, provident preservation fund and retirement annuity fund upon approval of their emigration by the SARB. As the concept of exchange control emigration is being phased out, the trigger for the withdrawal of these funds for emigrants will be reviewed.

The abolition of the so-called "loop" has been dealt with elsewhere herein, to be replaced by tax measures.

TAX RATES AND THRESHOLDS

INDIVIDUALS AND SPECIAL TRUSTS

For the first time in three years relief is given at all tax brackets, with significant percentage relief in the lowest three brackets.

Personal income tax rate and bracket adjustments

2020/21		2019/20	
TAXABLE INCOME (R)	RATES OF TAX	TAXABLE INCOME (R)	RATES OF TAX
0 – 205 900	18% of taxable income	0 – 195 850	18% of taxable income
205 901 – 321 600	R37 062 + 26% of the taxable income above R205 900	195 851 – 305 850	R35 253 + 26% of taxable income above R195 850
321 601 – 445 100	R67 144 + 31% of the taxable income above R321 600	305 851 – 423 300	R63 853 + 31% of taxable income above R305 850
445 101 – 584 200	R105 429 + 36% of the taxable income above R445 100	423 301 – 555 600	R100 263 + 36% of taxable income above R423 300
584 201 – 744 800	R155 505 + 39% of the taxable income above R584 200	555 601 – 708 310	R147 891 + 39% of taxable income above R555 600
744 801 – 1 577 300	R218 139 + 41% of the taxable income above R744 800	708 311 – 1 500 000	R207 448 + 41% of taxable income above R708 310
1 577 301 and above	R559 464 + 45% of the amount above R1 577 300	1 500 001 and above	R532 041 + 45% of taxable income above R1 500 000

Rebates

	2020/21	2019/20
	R	R
Primary	14 958	14 220
Secondary (Persons 65 and older)	8 199	7 794
Tertiary (Persons 75 and older)	2 736	2 601

Tax thresholds

	2020/21	2019/20
	R	R
Below age 65	83 100	79 000
Age 65 to below 75	128 650	122 300
Age 75 and older	143 850	136 750

Annual income tax payable and average tax payable comparison (taxpayers younger than 65):

TAXABLE INCOME	2019/20 TAX	2020/21 TAX	TAX CHANGE (R)	% CHANGE	AVERAGE TAX RATES	
R	R	R	R	%	New rates	Old Rates
85 000	1 080	342	-738	-68.3%	0.4%	1.3%
90 000	1 980	1 242	-738	-37.3%	1.4%	2.2%
100 000	3 780	3 042	-738	-19.5%	3.0%	3.8%
120 000	7 380	6 642	-738	-10.0%	5.5%	6.2%

150 000	12 780	12 042	-738	-5.8%	8.0%	8.5%
200 000	22 112	21 042	-1 070	-4.8%	10.5%	11.1%
250 000	35 112	33 570	-1 542	-4.4%	13.4%	14.0%
300 000	48 112	46 570	-1 542	-3.2%	15.5%	16.0%
400 000	78 819	76 490	-2 330	-3.0%	19.1%	19.7%
500 000	113 654	110 235	-3 420	-3.0%	22.0%	22.7%
750 000	210 320	205 313	-5 007	-2.4%	27.4%	28.0%
1 000 000	312 820	307 813	-5 007	-1.6%	30.8%	31.3%
1 500 000	517 820	512 813	-5 007	-1.0%	34.2%	34.5%
2 000 000	742 820	734 721	-8 099	-1.1%	36.7%	37.1%

Source: National Treasury

Retirement fund lump sum withdrawal benefits

2020/21		**2019/20**	
TAXABLE INCOME (R)	**RATES OF TAX**	**TAXABLE INCOME (R)**	**RATES OF TAX**
0 – 25 000	0% of taxable income	0 – 25 000	0% of taxable income
25 001 – 660 000	18% of taxable income above R25 000	25 001 – 660 000	18% of taxable income above R25 000
660 001 – 990 000	R114 300 + 27% of taxable income above R660 000	660 001 – 990 000	R114 300 + 27% of taxable income above R660 000
990 001 and above	R203 400 + 36% of taxable income above R990 000	990 001 and above	R203 400 + 36% of taxable income above R990 000

Retirement fund lump sum benefits or severance benefits

2020/21		**2019/20**	
TAXABLE INCOME (R)	**RATES OF TAX**	**TAXABLE INCOME (R)**	**RATES OF TAX**
0 – 500 000	0% of taxable income	0 – 500 000	0% of taxable income
500 001 – 700 000	18% of taxable income above R500 000	500 001 – 700 000	18% of taxable income above R500 000
700 001 – 1 050 000	R36 000 + 27% of taxable income above R700 000	700 001 – 1 050 000	R36 000 + 27% of taxable income above R700 000
1 050 001 and above	R130 500 + 36% of taxable income above R1 050 000	1 050 001 and above	R130 500 + 36% of taxable income above R1 050 000

CAPITAL GAINS TAX

Capital gains tax effective rate (%)

	2020/21	2019/20

Individuals and special trusts	18	18
Companies	22.4	22.4
Trusts	36	36

Capital gains exemptions

DESCRIPTION	2020/21	2019/20
	R	R
Annual exclusion for individuals and special trusts	40 000	40 000
Exclusion on death	300 000	300 000
Exclusion in respect of disposal of primary residence (based on amount of capital gain or loss on disposal)	2 million	2 million
Maximum market value of all assets allowed within definition of small business on disposal when person over 55	10 million	10 million
Exclusion amount on disposal of small business when person over 55	1.8 million	1.8 million

CORPORATE INCOME TAX RATES

Income tax – Companies

For the financial years ending on any date between 1 April 2020 and 31 March 2021, the following rates of tax will apply:

TYPE	RATE OF TAX (%)	
	2020/21	2019/20
Companies (other than gold mining companies and long term insurers)	28	28

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