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2023 SNG Grant Thornton Budget Commentary

February 2023

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Contents

2023 BUDGET ANALYSIS 2
Revenue Projections 4
Overall 4
Indirect Taxes 4
Corporate Tax 7
Personal Income Tax 7
Tax Statistic 7
Economic Outlook 8
Tax proposals 8
New tax incentives 9
Upcoming Policy Discussions/Changes 9
International Tax 9
Base erosion, profit shifting and digital services taxation 9
Extending the anti-avoidance provision to cover foreign dividends from shares listed in South Africa 10
Clarifying the foreign business establishment exemption for controlled foreign companies 10
Taxation of non-resident beneficiaries of trusts 11
Refining the participation exemption for the sale of shares in foreign companies 11
Refining the participation exemption for the foreign return of capital from a CFC 11
Other Social media shares .... **Error! Bookmark not defined.**
Twitter .... **Error! Bookmark not defined.**
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Azwinndini Magadani a Partner in the Tax business at SNGGT published the article named 2023 Budget analysis on 23 February 2023.

2023 BUDGET ANALYSIS

On 22 February 2023, Minister of Finance Enoch Godongwana delivered his 2023 Budget speech amid stage 6 of load shedding, rising cost of living and high level of youth joblessness. We provide herewith the analysis and the commentary of the some of the major budgetary items:

2022 Projected tax revenue versus projected actual

In the 2022 Budget, the main budget revenue for 2022/23 was projected to be R1.6 trillion. South African Revenue Service (SARS) is now expected to collect tax revenue amounting to R1,69 trillion for 2022/23, an amount which is R93.7 billion higher than the budgeted revenue. The positive variance of R93.7 was as a result of better-than-expected collections mainly from the mining sector due to the sector experiencing favorable high commodity prices. A continued recovery from the pandemic among companies in manufacturing and financial sectors also contributed to this strong revenue performance. An increased tax revenue without corresponding tax increases serves as an indication that the enforcement tools (tax audits and imposition of penalties) deployed by SARS are starting to bear fruits.

2023 projected revenue

The main tax revenue for the 2023/24 fiscal year is projected to be R1.8 trillion or
25.1 per cent as a share of Gross Domestic Product (GDP) in 2023/24. The attainment of this tax revenue target is based on the projection that South Africa will achieve the real economic growth of 0.9% for 2023. The ability of the Treasury to correctly project the performance of the economy has direct bearing on whether the tax revenue will be collected or not.

The tax-to-GDP is projected to reach 25.4 percent in 2022/23 and expected to reach 25.7 by 2025/26. These percentages are still low as compared to Organisation for Economic Cooperation and Development (OECD) countries average tax-to-GDP of 34.1%.

MAIN TAX PROPOSALS FOR BUSINESSES AND INDIVIDUALS

Businesses are currently experiencing financial hardships caused by poor economic growth and unreliable electricity supply. Much to the taxpayers’ relief, the Minister has announced that no significant tax increases will be proposed.

Corporate Income Tax (CIT)

The CIT rate is currently at 27%. No proposed changes to this rate.

Research and development incentives

The research and development incentive was due to end on 31 December 2023. There is now proposal to extend this incentive for 10 years from 1 January 2024.

Expansion of the renewable energy tax incentives

Currently, businesses are allowed to claim costs of the qualifying investment in wind power and concentrated solar energy over a period of three years (50% in year 1, 30% in year 2, and 20% in year 3) in terms of section 12B of the Income Tax Act. The Budget proposed a change to the incentive that will allow businesses to claim 125% of the costs of the qualifying investments in renewable energy with no thresholds on generation capacity in the first year.

Capital Gain Tax (CGT)

CGT is triggered by a disposal or deemed disposal of an asset. The effective rate of CGT remains at 22.4% for companies. No proposed changes.

Value Added Tax

VAT is levied at the standard rate of 15% on the supply of goods and services by registered vendors. No changes in the VAT rate were proposed.

Dividends Tax

Dividends tax is a final tax on dividends at a rate of 20%. No changes were proposed.

Carbon Tax

The carbon tax rate increased from R144 to R159 per tonne of carbon dioxide equivalent, effective from 1 January 2023. The carbon fuel levy for 2023 will increase by 1c to 10c/l for petrol and 11c/l for diesel from 5 April 2023, as required by legislation. It is proposed that the carbon tax cost recovery quantum for the liquid fuels refinery sector increases from 0.63c/l to 0.66c/l from 1 January 2023.

Rooftop Solar tax incentive

To increase electricity generation, the Minister proposed a rooftop incentive for individuals to invest in Solar PV panels. Individuals will be able to claim a tax rebate against their tax liability to the value of 25% of the cost of any new and unused solar PV panels, subject to a maximum amount of R15 000. This incentive will be available for one year, that is, from 01 March 2023 to 29 February 2024.

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Comments on other aspects of the budget prepared by various tax team members (name tax members and their qualifications and experience?). The comments below include content first published on social medial platforms like Twitter, LinkedIn and Instagram. Some of the information below is available on our website https://www.grantthornton.co.za/service/tax-advisory-services/, please pay us a visit for latest developments.

Revenue Projections

Overall

The Minister has announced that the revised tax revenue target for the 2022/23 is now R1.69 trillion form 1.59. The increase is attributed to broad-based corporate tax recovery in the second half of 2022/23 particularly in the financial and manufacturing sector despite softening commodity prices.

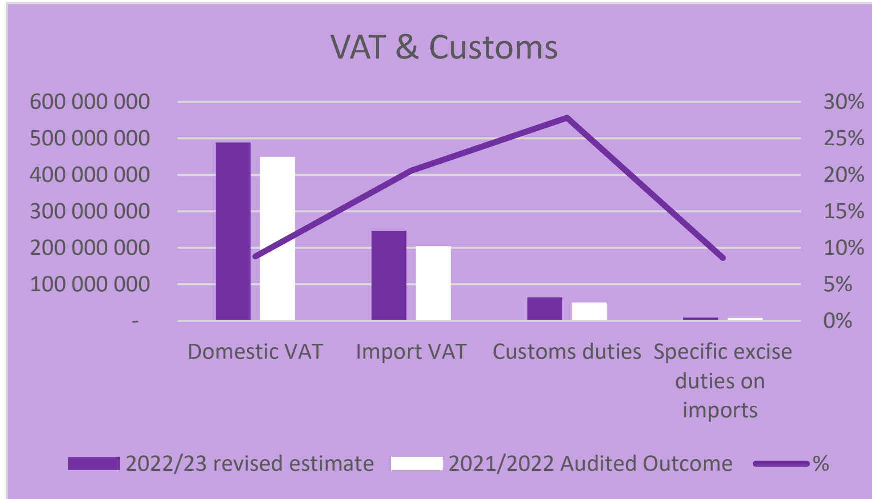
In addition, an improved tax compliance levels and efficiency in the tax administration is also noted to have contributed to the improved tax revenues.

To this end, the National Treasury kept its promise to not raise taxes or introduce a new wealth tax fill any tax gap.

The main tax revenue for the 2023/24 fiscal year is projected to be R1.787 trillion or 25.7 per cent of the Gross Domestic Product (GDP). To achieve the estimated tax revenue for 2023/24, the National Treasury expected that the real economy growth will average 1.4 for 2023.

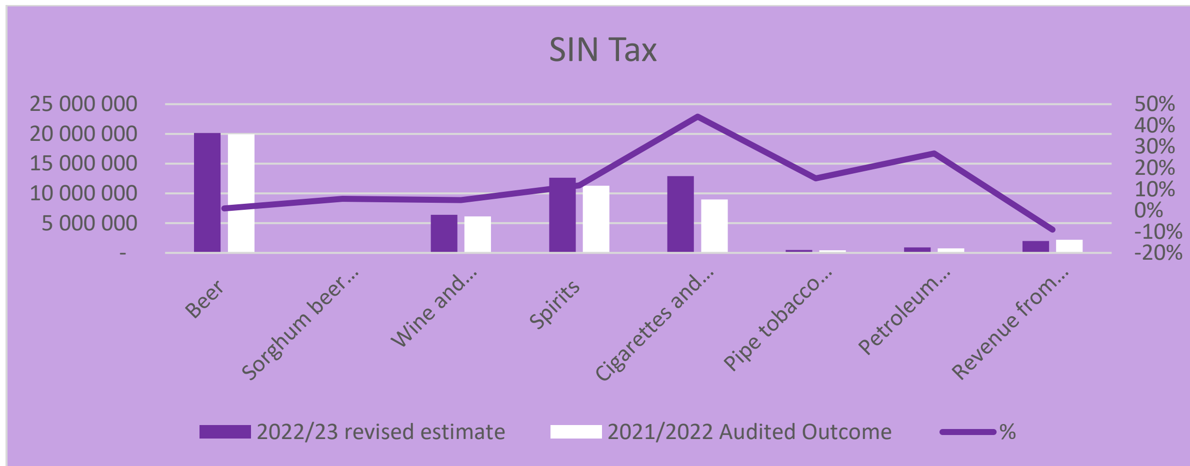
Indirect Taxes

VAT, Customs & Excise

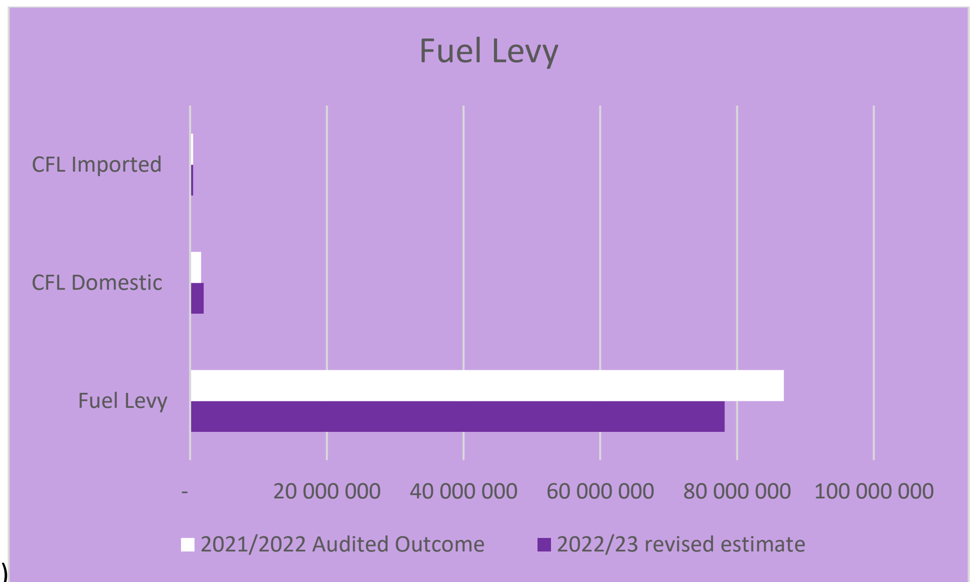


Increase in Import VAT possibly due to increase on online activity. Where online sales are the main driver to the Policy makers may over team need to consider impact on local industries… not comment was provided by the Finance Minister on the main drivers of Import VAT

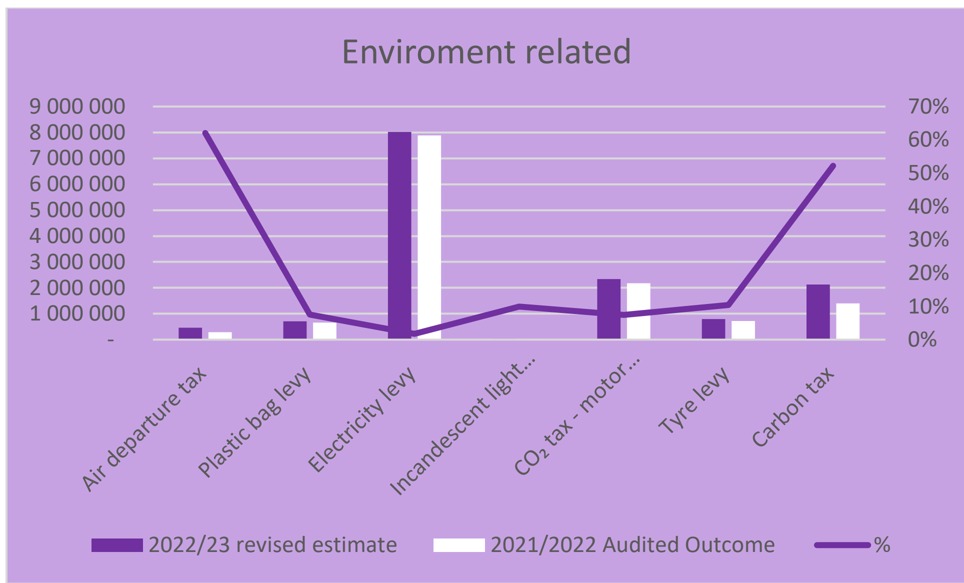
Increase related to Cigarette and tobacco related to increase in SARS enforcement activity



Decrease in fuel levy due temporary reduction of rate from 6 April to 6 July 2022 of R1.50 per letter and reduction of R0.75 from 7 July 2022 to 2 August.

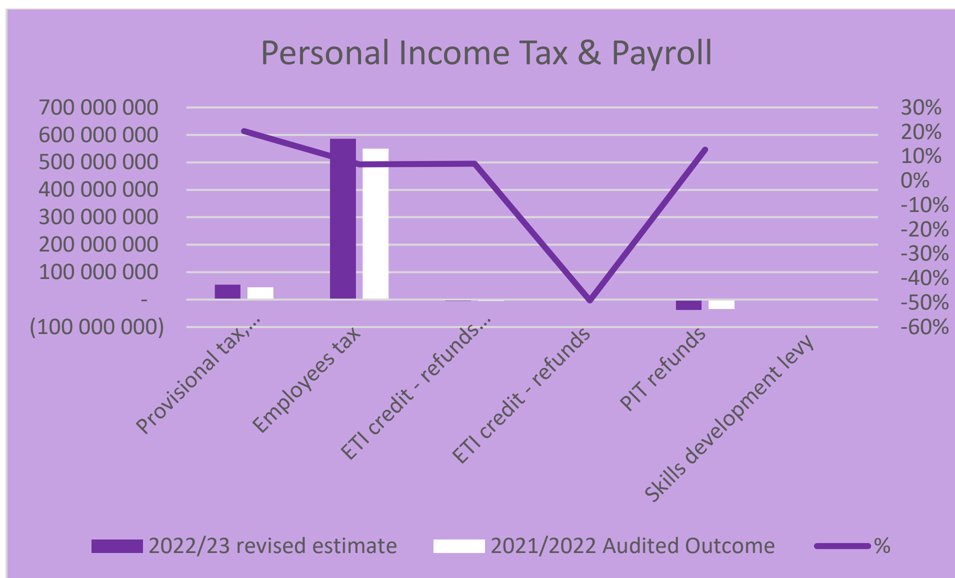


(Budget, 2023)



Corporate Tax

Personal Income Tax



Tax Statistic

Heading Tax to GDP ratio

The tax-to-GDP ratio is a measurement of the country's share of tax collection relative to the GDP. The higher the percentage, the higher the amount of tax revenue collections relative to the country's economy. A tax-to-GDP ratio of 25.4% is expected in the 2022/23, higher than the 24.7 per cent in the 2022 Budget Review. The ratio was 26,3 per cent of GDP before the pandemic, which indicate that the

country has not fully recovered from the pandemic, especially small and medium enterprise who continue to operate on a shoestring budgets and margins.

In what appeared as an unexpected move, the International Monetary Fund (IMF) has recently reported a slightly increase in the growth projections for the South African economy. According to IMF the economic growth is expected to reach 1.2% in 2023, an increase of 0.1%

A high tax-to-GDP ratio is an expression of a higher economic growth, durable economic activities and improvement in the tax compliance levels. A high tax-to-GDP ratio can be achieved, especially where taxpayers believe that they receive good value for their money, however, this is currently not a case in South Africa.

South Africa has a relatively high tax-to-GDP ratio compared to other developing countries. Although the country is expecting to achieve GDP growth of 2.5 percent in the 2023 to 2025, unless government takes urgent measures to reduce loadshedding and improve energy capacity, the economic growth prospects remain under an enormous threat.

Debt level

The gross debt stock is projected to increase from 4.73 trillion in 2022/23 to R5.84 trillion in 2025/26. Due to the increase in the gross debt, the debt-service costs were projected to be higher reaching an average R366.8 billion annually over the medium term and expected to reach R397.1 billion in 2025/26. The resources obtained are said to be otherwise used to address the pressing social needs, or to invest in the country's future. This aligns to the government's spending in which indicates that of more than half of the governments consolidated expenditure will be spent on social services.

Despite the increase in the government expenditure accompanied by the increase in gross debt, there seems to have been a decrease in the fiscal deficit which is said to be due to the revenue that is higher than expected. This seems to be good news for the country as the reduction in the fiscal deficit was reduced without tax increases or cuts in the social wage and infrastructure. This is also a clear indication that the government is heading in the right direction in addressing the sovereign default risk.

Economic Outlook

Tax proposals

New Sunset dates for corporate tax incentives

The South Africa Government previously indicated that they will review current tax incentives in a bid to simplify the tax legislation. In this regard in 2021 a couple of discussion papers were published by the National Treasury, a discussion paper on Research and Development incentive contained in section 11D of the Income Tax Act (R &D incentive) and a discussion paper the tax regime in the Oil and Gas sector.

The **R&D incentive** allows taxpayers to claim up to 150% of costs incurred on qualifying expenditure and allows for accelerated tax allowances on costs incurred to acquire qualifying assets for use in the qualifying R&D project. One of our key submissions in the discussion paper response was the incentive as it is

currently favors big businesses due to current requirements and complications related to certain interpretations within section 11D.

The Minister announced during the 2023 budget speech that the R&D incentive will be extended for 10 years and will be refined to make it simpler and more effective. The new sunset date for the R&D incentive is now set to be 31 December 2033. We hope the changes to the section will facilitate increased participation by Medium-Sized businesses.

Urban Development Zone (UDZ) tax incentive was introduced in 2003 with a view to promote investment in designated inner cities. The incentive is in the form of an accelerated depreciation allowance. The UDZ allowance is available in respect of the 'cost' (as defined in 13quat) of erection, extension, addition or improvement of any commercial or residential building, or part of that building, within an 'urban development zone'. The Minister announced during the 2023 budget speech that the UDZ incentive is set to be extended by two years to allow for the review of the incentive to be completed. The new sunset for the Urban development zone incentive will now be 31 March 2025.

New tax incentives

In an attempt to encourage businesses and households to invest in renewable energy, the Minister announced that;

- From 1 March 2023, businesses will be able to reduce their taxable income by 125 per cent of the cost of an investment in renewables. The incentive will be available for two years to stimulate investment in the short term.

- From 1 March 2023, Individuals who install rooftop solar panels quality to claim a rebate of 25 per cent of the cost of the panels, up to a maximum of R15 000. This can be used to reduce their tax liability in the 2023/24 tax year. The incentive will be available for one year only.

Upcoming Policy Discussions/Changes

International Tax

Base erosion, profit shifting and digital services taxation

The OECD/G20 Inclusive Framework has two pillars. Pillar One focuses on the digital economy while Pillar Two focuses on the remaining base erosion and profit shifting matters. It proposes that all internationally operating businesses with million pay an effective tax rate of at least 15 per cent, subject to certain

requirements and exemptions. The Minister has stated that government will publish a draft position on the implementation of Pillar Two for public comment and draft legislation will be prepared for inclusion in the 2024 Taxation Laws Amendment Bill.

Extending the anti-avoidance provision to cover foreign dividends from shares listed in South Africa

Section 10B of the act exempts foreign dividends received or accrued from shares listed on a South African stock exchange from normal tax. This exemption was introduced because these foreign dividends may be subject to dividends tax. It has been noticed that schemes have been devised to exploit this exemption. Accordingly, it is proposed that the round-tripping anti-avoidance provision for foreign dividends be amended to include foreign dividends received or accrued from shares listed on a South African stock exchange if the foreign dividends are directly or indirectly funded by amounts that were deductible in South Africa.

Interaction between the anti-avoidance rule and exemption applying to foreign dividends

The act contains an anti-avoidance rule in terms of which the participation exemption does not apply to a foreign dividend if any amount of the foreign dividend arises directly or indirectly from an amount that is deductible from the income of any person under the Income Tax Act. further exemption that applies to foreign dividends limits the effective tax rate for foreign dividends accruing to residents to a rate of 20 per cent. This exemption has the effect that amounts that are allowed to be deducted for income tax at a rate of 27 per cent or marginal tax rates are taxed at a rate of only 20 per cent where the anti-avoidance provision applies. It is proposed that the exemption to tax foreign dividends at 20 per cent should not apply where the anti-avoidance rule is applicable.

Clarifying the foreign business establishment exemption for controlled foreign companies

The act contains anti-avoidance rules in section 9D aimed at taxing South African residents on an amount equal to the net income of a CFC. The CFC rules contain exemptions for certain types of income. For example, amounts that are attributable to a foreign business establishment of a CFC. It has come to government’s attention that some taxpayers are retaining certain management functions but outsourcing other important functions for which the CFC is also being compensated by its clients. This is against the policy rationale of the definition of a foreign business establishment. It is proposed that the tax legislation be clarified such that, to qualify as a foreign business establishment, all important functions for which a CFC is compensated need to be performed by the CFC or by the other company meeting the requirements listed above.

Taxation of non-resident beneficiaries of trusts

Government is concerned about the difference between the rules covering the normal tax treatment of income attributed to beneficiaries of trusts in section 25B of the act and the rules covering the tax treatment of capital gains in relation to beneficiaries in paragraph 80 of the Eighth Schedule to the act. The flow through of amounts from South African tax resident trusts to non-resident beneficiaries makes it difficult for SARS to collect income tax from those non-resident beneficiaries as it is more complicated to enforce recovery actions against non-residents. To address this, it is proposed that changes be made to section 25B to align it with the provisions of paragraph 80.

Refining the participation exemption for the sale of shares in foreign companies

Paragraph 64B of the Eighth Schedule of the act contains a participation exemption relating to the sale of shares in foreign companies and section 10B contains a participation exemption relating to foreign dividends from foreign companies. The main aim of these exemptions is to encourage the repatriation to South Africa of foreign dividends and the proceeds on the sale of shares in foreign companies to non-connected non-residents. Government has identified certain transactions that do not achieve this aim but for which the participation exemption for the sale of shares in foreign companies applies. Accordingly, Government proposes changing the tax legislation to not grant the participation exemption if the sale of shares is to a non-resident company that formed part of the same group of companies as the company disposing of the shares, or the shareholders are substantially the same as the shareholders of any company in the group of companies disposing of the shares.

Refining the participation exemption for the foreign return of capital from a CFC

The participation exemption relating to the sale of shares in foreign companies is subject to certain qualifying requirements. One of these requirements is that the South African tax resident selling the shares in a foreign company should have held those shares for at least 18 months prior to the sale. In 2012, changes were made to the act to extend the participation exemption to apply in respect of the foreign return of capital from a CFC. However, the participation exemption for the foreign return of capital from a CFC does not have a similar 18-month holding